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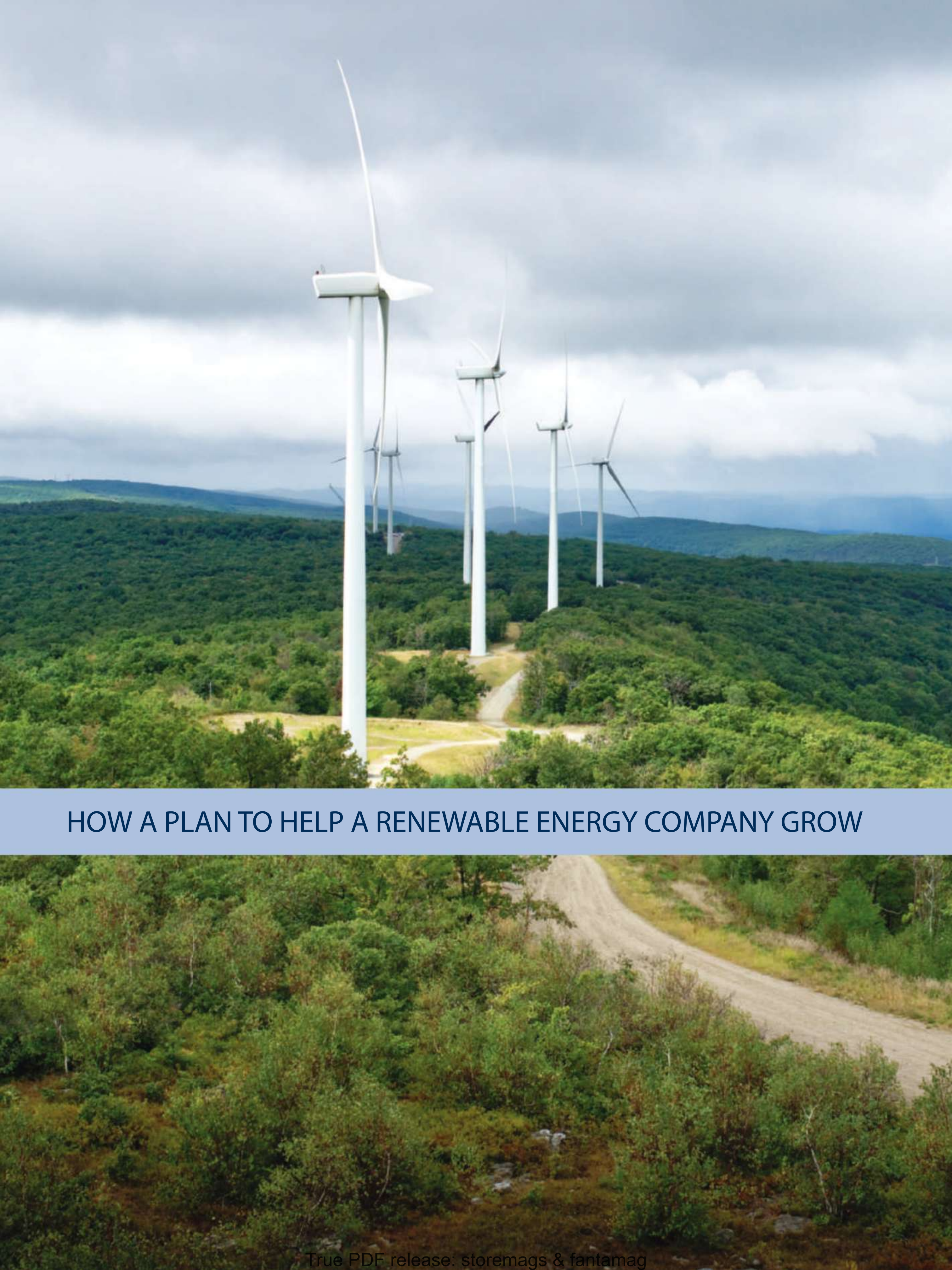
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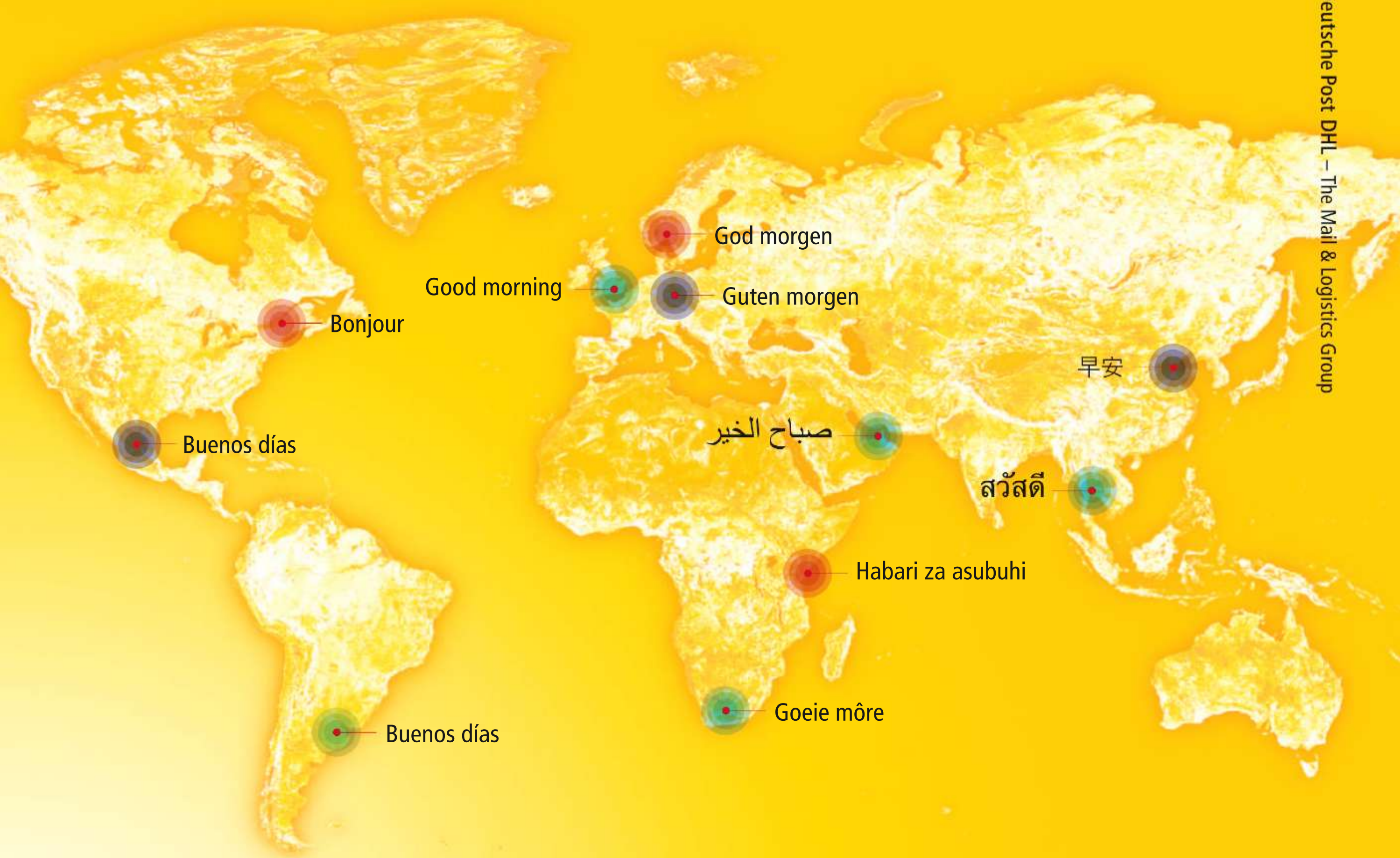
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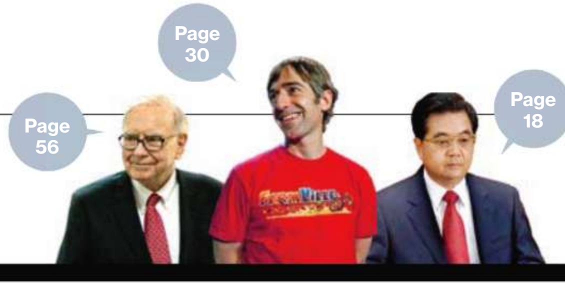
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Corrections & Clarifications

● "The Accounting Board Is a Sinecure Qua Non" (Politics & Policy, Oct. 4) stated that the Supreme Court rejected a constitutional challenge to the Public Company Accounting Oversight Board. The court ruled that Congress violated the Constitution by creating a board that lacked Presidential oversight because the Securities and Exchange Commission could remove its members only for cause. The court invalidated that clause, letting the SEC remove board members at will. It left intact the board and its regulatory powers. ● "Terry McAuliffe Pursues a New Shade of Green" (Politics & Policy, Oct. 11) incorrectly said the first 10,000 electric cars sold by his company would be sold for $10,000. The first 100,000 cars would be sold at that price. ● In "For Sale-ish" (Feature, Oct. 11), we erroneously reported that George Papaioannou was hired by the Greek government to consult on the potential sale of government-owned land. Papaioannou is the chief executive officer of Piraeus Real Estate, a unit of Piraeus Bank. The government retained Piraeus Bank, not Papaioannou directly.

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Opening Remarks



TODD HIDO, #1951 FROM THE SERIES HOUSE HUNTING/EDGE REPS

Mortgages Lost in the Cloud

The foreclosure documentation mess isn't just a clerical problem. It erodes certainty about property rights—the key to capitalism. By Peter Coy

The U.S. and other Western democracies have grown wealthy over the past three centuries for a simple reason: Their citizens have been able to establish clear title to land, buildings, and other property. So argues Hernando de Soto, the Peruvian economist, in his influential 2000 book *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*. While people in developed nations can borrow against their property and use the money to start businesses and accumulate wealth, he wrote, squatters in countries like Peru have no such option. Property rights beget prosperity.

That's why the burgeoning foreclosure mess in the U.S. strikes at the nation's economic heart. Confusion is so rife that Bank of America, the biggest mortgage lender, suspended foreclosures in all 50 states to determine whether faulty documents were used to confiscate homes. Americans took their title-recording system for granted, abused it during the housing boom, and let it deteriorate. "Somehow in the last 10 or 15 years, everything that was good record-keeping isn't telling the truth anymore," says de Soto, reached by phone while traveling in Copenhagen. "My feeling is this: Your recession is going to last. And it's going to last, and it's going to last, because essentially the trust has broken down."

De Soto may be an alarmist, but he has correctly identified why the foreclosure mess is not a simple clerical problem. It's part of a broader breakdown in the financial world–the one that nearly caused a depression in 2008 when banks and other financial players couldn't tell whose balance sheets were stuffed with toxic subprime mortgage debt and whose weren't. Unable to trust one another, the big institutions pulled back from every asset except Treasury debt. At the height of the crisis, even stalwarts like AT&T couldn't borrow in the commercial paper market for durations of more than a day–meaning they were only 24 hours removed from default.

That crisis is past, but its causes aren't. Uncertainty still reigns. Its current manifestation is faintly ridiculous: Lenders can't say for sure who holds a mortgage–which means that sales can't go through. Buyers won't put down good money for a property if they aren't sure they'll get clear title to it, nor will lenders extend loans. Buyers of hundreds of billions of dollars' worth of mortgage-backed securities may have grounds to sue. That could "rock the market," says Joshua H. Rosner, managing director of

Opening Remarks

"What characterized the rise of capitalism was that you actually created facts.... Now you've got plenty of information, but you don't have facts that can be tested for truth."
Hernando de Soto

Graham Fisher & Co., a research firm.

All this at a time when every imaginable bit of information–from your bank statement to your Facebook photos–seems to be stored in the cloud, ready for instant retrieval. Google "who owns my mortgage?" and you get a quarter of a million results in a quarter of a second. What the cloud can't tell you is what you really want to know, which is who actually does own your mortgage–that is, who has the power to throw you out on the street if you stop paying. The only way to verify that is to leave the cloud and dive into a recording system that predates the founding of the U.S.

Titles and mortgages on real property are officially recorded in county clerks' offices, a slow-moving, old-fashioned, deliberate world of ink, paper, and filing cabinets. The process has been perfected over a millennium, going back to the Domesday Book, the survey of English property completed in 1086 for William the Conqueror. This paper-based system, though admirably accurate and permanent, wasn't equipped for the era of rapid-fire refinancing and securitization. When over 8 million new and used homes are sold per year, as at the height of the boom, and most loans are packaged into securities, you need a lot of clerks.

The mortgage industry responded to the scale and speed of the modern housing market by creating an electronic overlay called Mortgage Electronic Registration Systems (MERS) in 1997. MERS, however, lacks the thoroughness and–more important–the legal standing of the old system. Some judges have rejected foreclosures based on MERS when the party claiming to hold the mortgage couldn't produce the note to prove to the court's satisfaction that it was in fact the creditor. The courts want to see paper.

State and local governments could have invested in digital record-keeping systems for real estate to preserve every legally important feature of the paper method, but with the speed and accessibility of a Google or a Facebook. Why didn't they? William Raftery, a communications and research specialist at the National Center for State Courts in Williamsburg, Va., says three things got in the way: state laws, which no one bothered to amend; court precedents dating back hundreds of years that demand paper records; and inertia. Says Raftery: "Things of this nature only happen when circumstances demand it."

The private sector couldn't afford to wait for government to catch up. Hence the MERS database, a unit of MERSCorp in Reston, Va., which was founded by Fannie Mae, Freddie Mac, and the mortgage industry. The concept was to avoid the cost and delay of recording the passing of loans from one party to another by naming Mortgage Electronic Registration Systems as the mortgagee for the lifetime of the loan, regardless of how many times it changed hands and to whom.

Some judges accepted MERS' right to foreclose on a delinquent homeowner. Others didn't. Instead of untangling the confusion early on, MERS forged ahead. It's now the mortgagee for more than 60 percent of new mortgage loans.

A promissory note–i.e., a paper I.O.U.–is the only legal proof of creditorship that courts ordinarily accept. Incredibly, though, the Florida Bankers Assn. told the state Supreme Court that when its members converted to electronic records, "the physical document was deliberately eliminated to avoid confusion." Further angering judges, MERS deputized bank executives to handle foreclosures, making it unclear who the people appearing in court really worked for. In Brooklyn, state Supreme Court Justice Arthur Schack in 2009 rejected a foreclosure in which a Bank of New York executive identified herself as a MERS vice-president. He called her "a milliner's delight, by virtue of the number of hats she wears." Ally Financial said in September that it found a "technical" deficiency at its GMAC Mortgage unit that let employees sign foreclosure documents without a notary present or with information they didn't know was true.

If the transition from paper to terabytes were unprecedented, it would be easier to give lenders a pass. But the banks behaved more straightforwardly in 2003 when they sought permission to digitize paper checks–a similar legal leap, since electronic copies had long been considered unacceptable in court. The banks lobbied Congress, which in 2003 passed the Check Clearing for the 21st Century Act. Now your monthly bank statement contains images of your checks instead of the paper, saving time and money. Because the reform was done with the blessing of Congress, there have been few problems.

MERS executives say their system will overcome legal challenges. "We find it very ironic that we're being accused of all these different wrongdoings when in fact we brought a lot of clarity to not just the industry but homeowners," says Karmela Lejarde, a MERS spokeswoman. There's some truth in what Lejarde says. This year, MERS opened its system so homeowners can find out for free online who their loan's servicer is and (usually, but not always) who owns the loan.

The problem is that the data in the MERS system isn't verifiable or legally binding. That recalls de Soto's insight into what made the U.S. work so well in the first place. "What characterized the rise of capitalism was that you actually created facts–statements that can be tested for truth. Now you've got plenty of information, but you don't have facts that can be tested for truth. Can you have a prosperous market economy without knowledge of who owns what and how they're related?" We know the answer to that one. B *–With John Gittelsohn*

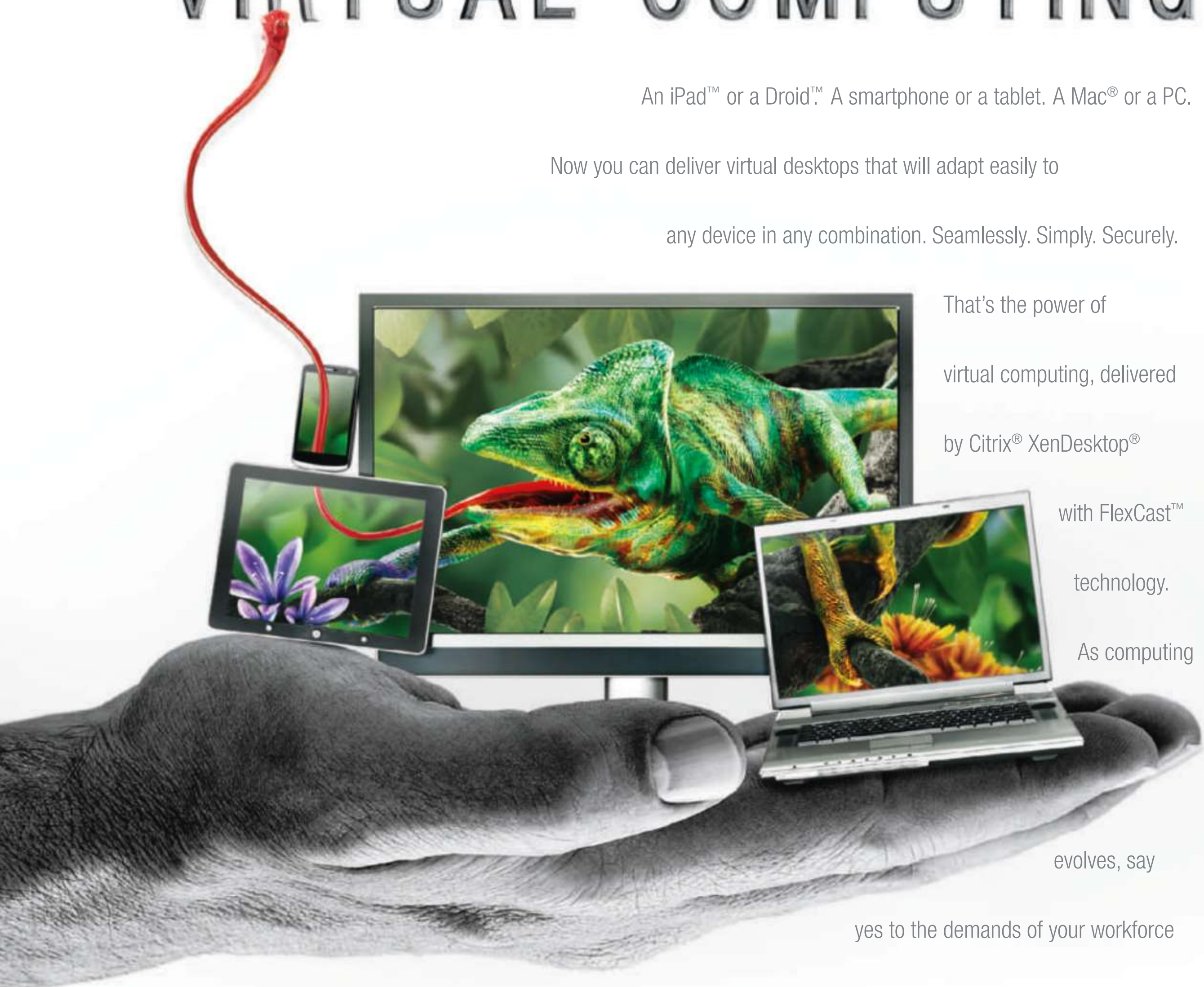
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Global Economics



A $14.5 Trillion Economy Stuck in Neutral

▶ **The U.S. won't be able to export its way out of this slump as a global currency war threatens**

▶ **"If you compare where we are to the early stages of Japan's lost decade, we're doing worse"**

When countries suffer financial crises, history shows, they generally climb back out of them via exports. Their currency falls, and the parts of the world that didn't go through a financial crisis help them out of their hole by snapping up their goods and services and putting their people back to work.

This time it's not so easy. The financial crisis wasn't felt in just a single country. Last year was the first year since the Great Depression in which the economic output of the entire world declined. What's more, the countries that are growing quickly now, such as China, aren't willing to step up their imports to stimulate growth in the weaker economies. China and others are actually depressing their currencies to gain or maintain an outsized share of the stunted global demand. Brazilian Finance Minister Guido Mantega warned on Sept. 27 of a "currency war." The problem is that it's a mathematical impossibility for all countries to grow by keeping exports high and imports low. "There isn't another planet to export to," says Paul Krugman, the Nobel prize-winning Princeton University economist and *New York Times* columnist.

Companies can't postpone replacing old structures and equipment indefinitely

What now? For the U.S., the world's biggest economy, the question is what it will take to restore healthy growth, if it's not going to be trade. Economists interviewed by *Bloomberg Businessweek* and Bloomberg News offered an intriguing variety of answers, from technology to animal spirits to the simple passage of time. Most, however, say the U.S. recovery could remain subdued for several more years—and

CHRISTIAN SCHMIDT/GALLERY STOCK

Global Economics

there's still a possibility that growth will stall out altogether, sending the economy back into a recession.

Complicating matters, the hole from which the U.S. economy needs to escape is unusually deep. As the accompanying chart shows, employment in September remained 5.6 percent below its December 2007 peak. In four of the five previous recessions going back to 1970, employment had bounced back to new highs by this stage. The only exception was the aftermath of the 2001 recession, in which employment was 1.8 percent below its pre-recession peak at this stage.

The risk is that the economy will get stuck in a rut. Companies won't hire and increase production because they don't see any demand, and consumers won't spend because companies aren't hiring and because they're still trying to increase savings to make up for the destruction of household wealth in the financial crisis. "The effects of financial crises tend to be really, really protracted," says Krugman. "Japan is still a depressed, fragile economy 18 years after its banking crisis. If you compare where we are to the early stages of Japan's lost decade, we're doing worse. We've got a deeper slump, more unemployment, and overall a weaker policy response."

Quoted

"In January of '07 everybody was coming to me and saying 'if you don't deregulate, we're all going to London.' Well, we learned in London they were being told the same thing. I don't think that it's in anybody's interest to have that kind of race to the bottom."
—Senator Chris Dodd (D-Conn.)



On Oct. 5, Goldman Sachs said there's about a 25 percent to 30 percent chance that the economy will dip back into recession. Goldman's chief U.S. economist, Jan Hatzius, predicted that the unemployment rate will rise back to 10 percent in early 2011 and noted that in the postwar U.S. economy, "we have never seen an increase in the unemployment rate (on a three-month moving average basis) of more than one-third of one percentage point that did not coincide with or foreshadow a recession."

Technological innovation is one potential savior. Edmund S. Phelps, a Nobel prize-winning economist at Columbia University, says "there is a rising reservoir of new, undeveloped, untried methods. At some point, the dam will burst." In Phelps' scenario, some entrepreneur will try to get a jump on his or her competitors by investing heavily in a new technology. Rivals will be forced to respond to avoid losing market share, and a virtuous upward spiral will begin.

Or maybe wear, tear, and obsolescence will come to the rescue. Companies can't put off replacing old structures and equipment forever, note Phelps and Hatzius. Housing construction is so slow that "it is almost mathematically impossible to see another big drop in it," Hatzius wrote Oct. 5.

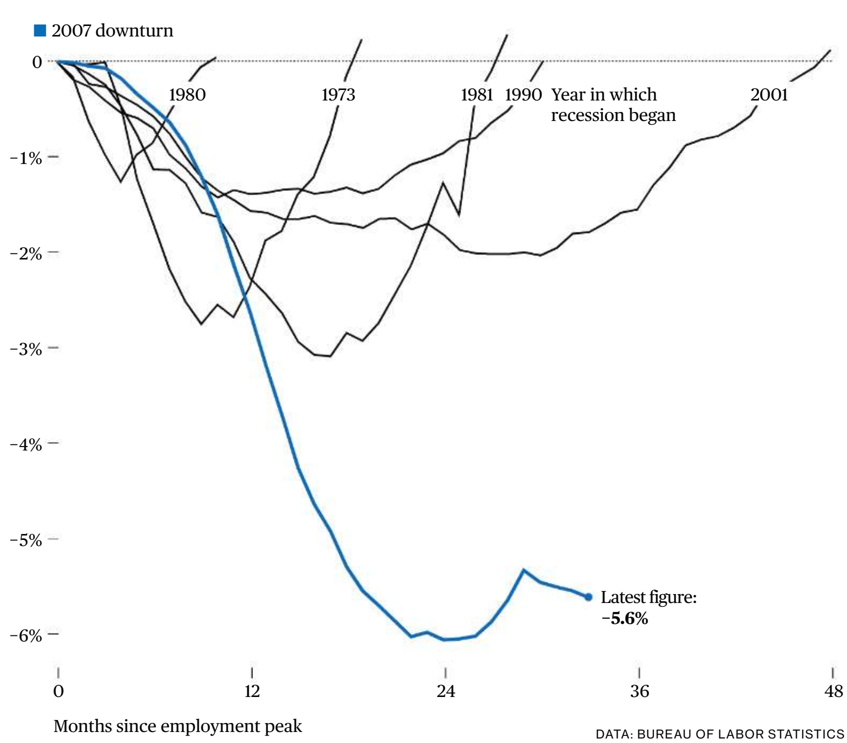
The U.S. private sector is gradually working off its over-indebtedness. Ricardo J. Caballero, an economist at Massachusetts Institute of Technology and an expert on international financial crises, wrote in an e-mail exchange that the damage from the financial meltdown in the U.S. "takes some time to repair, perhaps a couple of years, but not a decade." In contrast to Japan, Caballero wrote, the U.S. has healthy corporate profits and productivity growth and lacks the "zombie" companies that sap the economy's strength.

Perhaps the U.S. economy's salvation lies in dullness. That, anyway, is what former Federal Reserve Chairman Alan Greenspan said on Oct. 7 at the Bloomberg FX10 conference in an onstage interview with Bloomberg's Tom Keene. Greenspan said that it's useless to try to stimulate business executives' animal spirits as long as they're still fearful of another financial calamity. What's required, he said, is an extended period of calm—long enough for executives to regain their confidence and start thinking about new opportunities again. In other words, Greenspan said, "boredom." —*Peter Coy*

The bottom line *With several countries using their currencies to prop up exports, the U.S. likely will need technological innovation and time to recover.*

Deep in a Hole

Percentage change in employment from business-cycle peak



DATA: BUREAU OF LABOR STATISTICS

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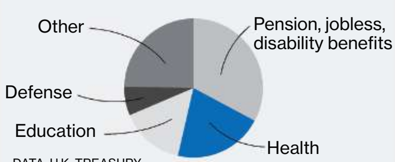
Cameron at the Conservative Party's annual conference in Birmingham

Government Spending

Cameron Will Spare Funding for Health Care

▶ He has vowed not to touch the NHS, making cost-cutting difficult

▶ Britain's 2010-11 Budget



DATA: U.K. TREASURY

As it prepares to unveil the details of the biggest peacetime budget cut in U.K. history, Prime Minister David Cameron's government has been debating whether to save aircraft carriers, benefits for stay-at-home moms, and other big-ticket items. The task has been made especially hard because of a promise Cameron made to voters four years ago. The Conservative leader, seeking to broaden his party's appeal after three successive election defeats, pledged that he would increase funding to the country's National Health Service every year if elected. At the time, the vow did not seem like a potential political liability: The country was in its 15th straight year of growth, and funding the NHS, which gives free medical care to all U.K. residents, seemed an easy promise to keep.

Now, with a target of balancing the books by 2015 amid a fragile economic recovery, honoring the vow to protect the government's second-largest expenditure—122 billion pounds ($192 billion) this year —means other departments will face bigger cuts when the budget is unveiled on Oct. 20. "The spending plans set out in the emergency budget imply a 14 percent cut in spending by central government by 2014-15," says Carl Emmerson, acting director of the Institute for Fiscal Studies, an independent think tank. "Once the coalition government's commitments to increase spending on overseas aid and the NHS are taken into account, the average cut elsewhere rises to a much deeper 25 percent." (A category that includes pensions and disability and unemployment benefits is the biggest government expenditure.)

Talking to reporters on Oct. 11, Cameron acknowledged the strain. "The conversations we're having within the spending review process are difficult, and we've got very difficult decisions to make," he said. Conservative lawmakers, including former Chancellor of the Exchequer Nigel Lawson, have urged Cameron to ditch the pledge to spare the NHS. Liberal Democrat Vince Cable, now Business Secretary in the coalition government, argued against the pledge before the election.

Still, according to Philip Cowley, a political scientist at the University of Nottingham and co-author of the book, *The British General Election of 2010*, the NHS promise may have been what got Cameron the top job. "The NHS is a totemic issue for the British people," he says. "It wasn't an accident that the Conservatives chose to open their election campaign by reminding people of their commitment, and it worked. Labour couldn't throw anything at them over health." Ditching that promise and actually cutting the NHS budget would alienate some who voted Conservative. It could also increase dissension in the Liberal Democratic Party, the Tories' partner in government, to dangerous levels.

According to the King's Fund health think tank, even Cameron's plan to increase NHS spending by the bare minimum will feel like a cut, as baby boomers get older and demand ever more expensive treatments. The danger for Cameron, then, is that voters will think he has broken his promise.

On Oct. 4, Cameron got his first taste of the pain to come, when his government announced plans to save 1 billion pounds by denying affluent parents a monthly payment they previously qualified for. After a day of outrage, the Prime Minister hinted he might look for a way to compensate some of the losers through tax breaks. He has a mere 82 billion pounds in more cuts to go.
—*Robert Hutton and Thomas Penny*

The bottom line *Cameron's pledge not to cut the NHS budget helped get the Tories elected. Keeping that pledge makes budget-cutting harder.*

Cartels

Creating the OPEC Of Fertilizer

▶ A few companies aim to dominate the global potash industry

▶ "Any attempt to monopolize prices would affect productivity"

The world's largest potash miners, whose control over output already exceeds that of OPEC over oil, are poised to tighten their grip on the industry even further.

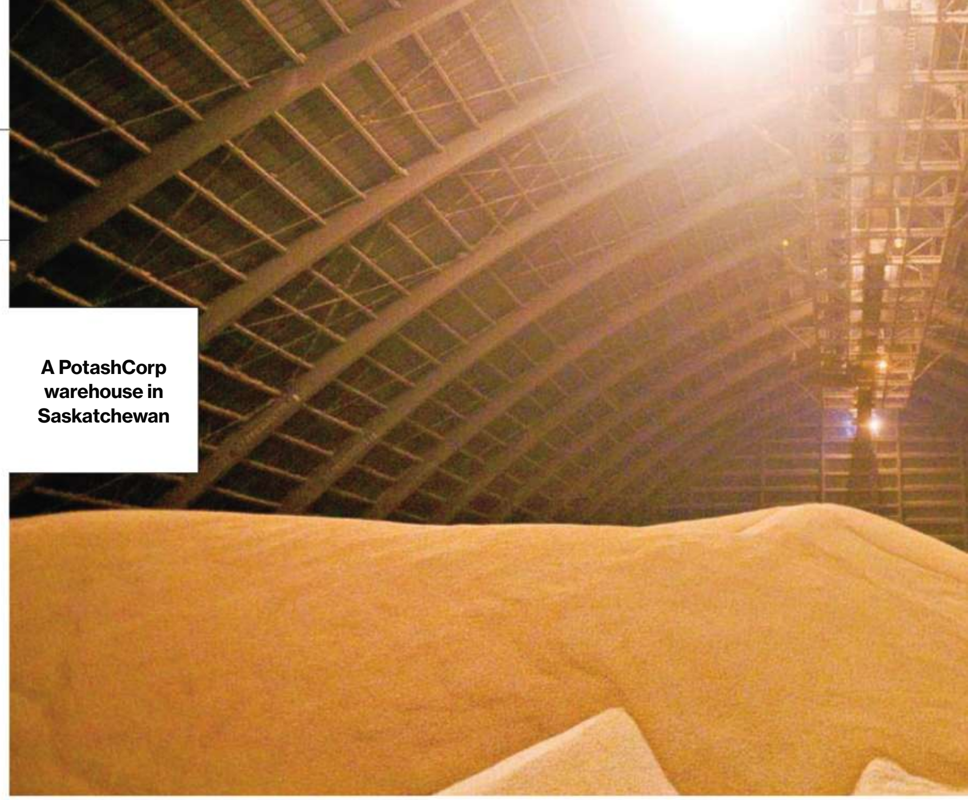
BHP Billiton's $40 billion hostile bid for Canada's **PotashCorp** would combine BHP, which plans to produce 8 million tons a year of potash on its own,

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with the industry's biggest company, which can produce 12 million tons a year. In Russia, a merger between two major potash miners, **Silvinit** and **Uralkali**, is under negotiation as well.

With the global population growing by 75 million a year, food demand will put further strain on harvests, increasing the need for fertilizer. Consolidation among producers of potash, a form of potassium used to boost crop yields by helping plants withstand dry conditions, has set off alarms with the big importers. "India has limited land to support a large population and any attempt to monopolize and increase fertilizer prices would affect productivity," says U.S. Awasthi, managing director of the Indian Farmers Fertiliser Cooperative (IFFCO), which buys from PotashCorp, among others. "Food prices will go up."

A fivefold surge in potash prices in 2007 and 2008 led to at least eight class actions filed in U.S. courts by farmers and farm suppliers against the leading producers over alleged collusion, a claim the producers deny. (The suits are ongoing.) Potash was among the last commodities to plunge in the global recession. PotashCorp used just a third of its capacity last year, while none of its seven largest rivals used more than 80 percent, according to the company and Fertecon, a U.K.-based industry consultant and price monitor. Prices hit a record of about $1,000 a metric ton for spot deliveries in 2008. They have since fallen to as low as $350.



A PotashCorp warehouse in Saskatchewan

36

PERCENT

Share of voters surveyed by Bloomberg News who consider President Barack Obama to be anti-business. In contrast, more than three-quarters of investors, analysts, and traders surveyed in September said Obama is anti-business.

The mergers could increase the clout of the trading companies that market and ship potash on behalf of most of the world's producers. **Canpotex** is the trading company for PotashCorp as well as another Canadian producer and **Mosaic** of the U.S.: It accounts for 40 percent of global trade. **Belarusian Potash** handles trade for the producer in Belarus and Uralkali of Russia. While Belarusian Potash controls about 30 percent of global exports, that figure would rise to more than 44 percent if Uralkali merged with its Russian rival.

Belarusian Potash alone could end up managing a greater portion of sales in its industry than OPEC, which controls 41 percent of global oil output. While OPEC's 12 members hold 70 percent of proven crude reserves, Canada, Russia, and Belarus have 80 percent of the world's potash. "It's a classic oligopoly," says Barrie Bain, director of Fertecon. While BHP has said it wants to sell its own potash and not join Canpotex, Bain says that BHP is unlikely to do so in the short term. Such a move would weaken the marketing power of Canpotex and put downward pressure on prices.

Potash and oil aren't the only concentrated markets. **Coca-Cola** controlled 47 percent of the world's soda market while **PepsiCo** had 21 percent in 2007, according to Euromonitor International. Gillette, a unit of **Procter & Gamble**, has a 72 percent market share in razors. "Gillette's monopoly does irritate me, but I can always grow a beard," says Eric Kraus, head of strategy at brokerage Otkritie Financial in Moscow. "It's a little bit more difficult to go without food. The semi-cartel in potash may look very threatening in the event of renewed pressure on grain supply."

The countries that rely heavily on potash are figuring out their response to the increased concentration in the industry. India, which imports all the 5.6 million tons of potash it needs annually, will resist any price moves above the current $380 a ton, says IFFCO's Awasthi. Brazil has mandated Rio de Janeiro-based mining giant, **Vale,** to start developing its own potash deposits. The company said in August it would invest $12 billion by 2014 to become the world's No. 2 in potash and phosphate.

80%

Share of the world's potash reserves located in Russia, Canada, and Belarus

China, alongside India, has shown interest in buying part of Belarus' state potash miner and said on Oct. 9 that it had uncovered new potash resources at home. China, the largest potash importer in 2008, needs to supply food for

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22 percent of the world's population while possessing less than 10 percent of the globe's arable land. "The risk of sovereigns getting involved and building big mines is real," says Xavier Majic of Passport Management, a San Francisco-based fund. "There are assets out there big enough to disrupt this industry." —*Yuriy Humber and Maria Kolesnikova*

The bottom line *BHP's bid for Canada's PotashCorp is just one of several deals that could increase the clout of a few industry players.*

Currencies

Hong Kong, Laboratory For a Free Yuan

▶ Beijing is encouraging the city to try new ways to use the currency

▶ "The pace of relaxation has been spectacular the past few months"

While the U.S. and Europe pressure China to weaken the yuan, Beijing is trying to reduce China's reliance on the dollar and promote the yuan as a top currency for international transactions.

The center of the action is Hong Kong. Policymakers from Beijing and Hong Kong are trying to make it easier for the city's importers, exporters, banks, insurance companies, and other businesses to use China's currency for transactions. If the experiment succeeds in Hong Kong, Beijing is likely to roll the idea out globally. "It's the birth of possibly the third international currency," says Julia Leung, Hong Kong's under secretary for financial services and the treasury.

Until recently, the yuan wasn't even widely accepted in Hong Kong, which kept its dollar-pegged currency after the departure of the British in 1997. Companies importing and exporting to the mainland haven't been able to use yuan to settle their deals, and locals couldn't use the currency freely. Thirteen years after the handover, residents still can buy only a maximum of 20,000 yuan ($3,000) a day.

Now demand for yuan is surging. High-end retailers, after initial reluctance, accept payment in yuan from Chinese tourists. With analysts expecting Beijing to let the yuan appreciate steadily against the greenback, Hong Kong citizens can't get enough of the currency. Yuan deposits in Hong Kong have gone from 62.7 billion yuan in January to a recent 130 billion.

Hong Kong has to figure out what to do with all this yuan. One solution is for its citizens and companies to take the yuan they get and spend it in China, an approach Beijing is allowing. "You can use [yuan] to pay salaries, settle bills cross-border, pay your electricity and water in China," says Stephen Chan, deputy general manager for corporate banking at Bank of China (Hong Kong).

Another way to soak up Hong Kong yuan is to issue yuan-denominated securities. In August, **McDonald's** became the first U.S. company to sell a 200 million-yuan bond to Hong Kong investors. The proceeds will boost the company's working capital in China.

Hong Kong insurers now have permission to settle Hong Kongers' life insurance and savings plans in yuan. Hong Kong banks can invest their yuan holdings in the Chinese interbank bond market. Hong Kong's securities regulator authorized Shanghai's **Haitong Securities** to raise as much as 5 billion yuan from Hong Kong investors for a fixed-income fund. "The pace of relaxation has been particularly spectacular the past few months," says H.S. Tong, chief operating officer at Bank of East Asia.

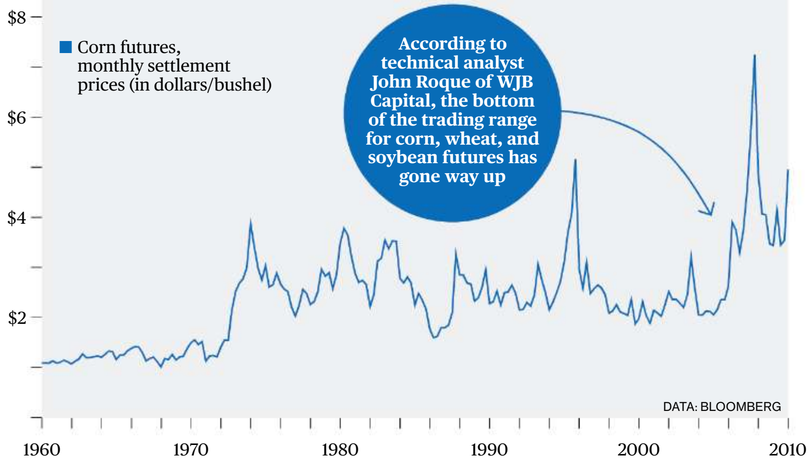
The Chinese government still keeps its capital account closed and restricts changes in the yuan's value. "China is trying to internationalize its own currency before it becomes convertible," says Leung. The full liberalization of the yuan is a ways off. The Chinese, however, are moving in that direction. —*Bruce Einhorn*

The bottom line *Hong Kong is becoming a financial laboratory for the yuan, which Chinese authorities want to make into an international currency.*

Commodities

The Pop in the Price of Corn

The U.S. government recently cut supply estimates for corn, prompting a surge in prices. Even before that, corn prices had been rising. In the quarter century before 2006, the low end of corn futures contracts came in at about $2 a bushel. In 2006 it rose to $3.



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In Asia, so many flights, so few pilots page 24 ▶



Central Planning

Leaping Forward, China May Grow More Slowly

▶ The 12th Five-Year Plan will stress a better safety net for the masses

▶ "You can't accuse China" of not having a long-term vision

High-level Communist Party officials will meet this month to craft China's latest Five-Year Plan. The 12th such policy statement since the founding of the People's Republic in 1949, it will be refined in coming months before its formal unveiling at the National People's Congress next March.

Some analysts say that in today's China the plan has little relevance. Others disagree. "In many countries one can say the governments don't have long-term vision, but you can't accuse China of that," says World Bank economist Louis Kuijs. The bank tracked the record of the 11th plan and found progress on goals such as health care and pension reform. China was less successful at boosting energy efficiency. The U.S. Chamber of Commerce in China watches the plans to spot industries getting special favor from Beijing.

The 12th Plan is expected to strongly emphasize a shift to domestic consumption (which still only makes up around 36 percent of gross domestic product) and less reliance on export manufacturing and heavy industry. Big topics will include solving growing income inequality, building up the social safety net, boosting the minimum wage, encouraging the services sector, and driving investment into the lagging interior of China. Another goal, encouraging urbanization, could mean further reform of the *hukou*, or household registration, system. The *hukou* system, though no longer enforced as stringently as in the past, requires residents to apply to relocate and often impedes the free movement of unemployed peasants to the cities.



President Hu Jintao presides over his last Five-Year Plan

China's quest for more balanced growth is likely to mean a reduced GDP target, maybe 7 percent a year. That would be down from 7.5 percent in the last plan, which was well below the average recent growth rate of 11.4 percent.

Analysts also will be watching the meeting to see if Vice-President Xi Jinping, the likely successor to President Hu Jintao, is named a vice-chairman to the central military commission, a key step in his rise to paramount leader. If Xi is not named to the commission at the meeting, it could indicate some opposition to his anointment, says Cheng Li, a scholar at the Brookings Institution in Washington. —*Dexter Roberts*

The bottom line *China's 12th Five-Year Plan will stress balanced growth, more urbanization, a better safety net, and a higher minimum wage.*

The Sports Economy

The Red Sox-Liverpool Deal as a Global Model



▶ U.S. baseball clubs and British soccer teams find common ground

▶ Old-fashioned stadiums, hated rivals: Looks like a match

When the English soccer club **Liverpool FC** agreed to be acquired by the **Boston Red Sox** ownership group, **New England Sports Ventures**, on Oct. 6 for $478 million, observers noted the similarities between the teams and their fans. Both cities absorbed massive waves of Irish immigrants during the potato famine of the mid-19th century; both have tricky accents. In addition, these clubs play in old parks cherished for their tradition and derided for

Tom Keene's EconoChat

Tom talks about jobs with **James Glassman,** senior economist for JPMorgan Chase

What's happened in the last 30 days in the economy?
Actually, an awful lot of positive things are starting to happen. Yet the latest employment report on Oct. 8 [which showed more jobs lost than expected] is a reminder how deep a hole we fell in.

Jobs are a lot worse.
Absolutely. We're getting GDP up by pushing people harder and working longer hours, improving productivity. That helps profits, but it's not so brilliant for jobs.

And Alan Greenspan has pointed out that people who have been out of work six months or more are not going to have the skills to come back into the workforce.
Well, yes, that's what happens. But you know what? There are a lot of jobs that don't take tremendous skills. Just give us work, and we can figure it out, I think, for a lot of people. I think the real disaster of downturns is the lost opportunity, the income and wealth we're not creating.

What could help companies feel more confident about hiring?
For the business community, from my point of view, conditions are spectacular. I don't understand these surveys that say businesspeople are depressed, because profit margins are at record levels. It's the workers who really lost out, and they just have to see that we have to wait, because it takes time to get an economy moving fast enough to generate jobs. Ⓑ

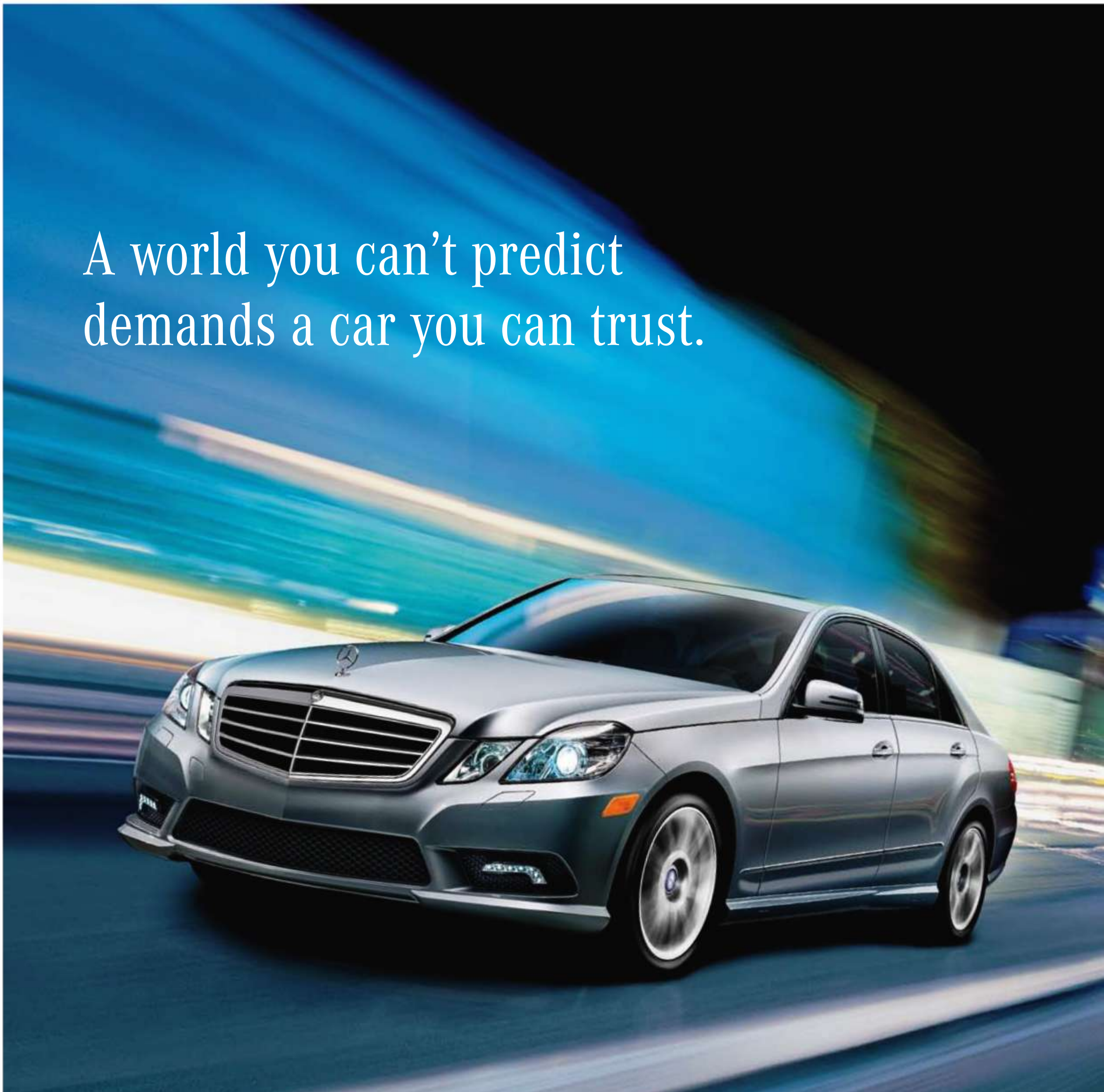


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their cramped conditions—the Red Sox at Fenway Park and Liverpool at Anfield. Finally, both feed on resentment toward their wealthier, more famous rivals—the **New York Yankees** and **Manchester United**, who, by the way, have a marketing partnership.

If the Red Sox offer clears legal challenges and a rival bid, it could provide a template for other possible multinational, multisport combinations:

Aston Villa/Chicago Cubs
Birmingham, the home of **Aston Villa**, and Chicago are both known as the “second city” in their countries. Aston Villa plays at Villa Park, a 113-year-old stadium with an iconic façade nestled in the neighborhood of Aston on Birmingham’s north side. The **Cubs** play at Wrigley field, a 96-year-old park with iconic façade nestled in the neighborhood of Wrigleyville on Chicago’s north side. Both clubs have local rivals to the south—**Birmingham City** and the **White Sox**. Aston Villa won the top division in 1910 and has won only once since, in 1981. The Cubs won the World Series in 1907 and 1908 and haven’t won since.

Manchester City/New York Mets
The two clubs play second fiddle in their own cities to dominant franchises—Manchester United and the Yankees. In 2003, **Manchester City** moved from Maine Road, a now-demolished stadium (where the Rolling Stones played in 1990), to the largely publicly financed City of Manchester Stadium. In 2009, the **Mets** moved from Shea, now demolished (the Rolling Stones played there in 1989), to the largely publicly financed Citi Field. Recently both teams have spent massively on players with little to show for it.

Leeds United/ Pittsburgh Pirates
Leeds had its glory years in the 1960s and ’70s under manager Don Revie and a brief revival in the early ’90s. It now dwells in the obscurity of England’s second division. The **Pirates** had their glory years in the ’60s and ’70s with legends Willie Stargell and Roberto Clemente. A brief revival occurred in the early ’90s. Now they lead the league in losses, with 105 last season. **B**

—*Ira Boudway*

The bottom line *Transatlantic pairings of sports underdogs? They could work. Think of the airline tie-ins and the T-shirts.*

Events of note in the week ahead

Seven Days

by Ira Boudway

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IPO for quilted bag maker Vera Bradley on Nasdaq

Earnings reports from Citigroup, IBM, and Halliburton

▶ **Apple earnings report:** Sales for the quarter could hit $18.9 billion, up threefold since the iPhone’s debut in 2007.



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Fifth European Central Bank Conference on Statistics

Earnings reports from Coca-Cola, UnitedHealth, Yahoo!, and Bank of America



▶ **India Digital Networks Summit:** Indian pay-television executives gather in New Delhi.

▶ **U.S. housing starts for September:** Surveyed economists expect 10,000 fewer than in August.

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U.S. Federal Reserve Beige Book report

Bank of Canada monetary policy report



▶ **China’s third-quarter GDP:** Analysts expect the pace of China’s growth to fall below 10 percent.

▶ **Delta Air Lines earnings report:** Higher fares could boost profit as much as 15-fold from last year.



21

Brazil’s unemployment rate for September

Earnings reports from McDonald’s, Philip Morris, Xerox, AT&T, Southwest Airlines, and Amazon.com

▶ **UPS earnings report:** The shipping company plans to hire 50,000 holiday season workers again this year.

▶ **FIAC art fair opening:** 3,500 contemporary artists from 194 galleries display their work in Paris.

22

G-20 finance ministers meet in Korea

Germany’s Leading Economic Index

▶ **Verizon earnings report:** Analysts expect a 5.8 percent gain in earnings per share as new smartphones have wireless customers paying extra for data plans.

23

Sarah Palin at Victory 2010 rally for Republicans in Orlando, Fla.



▶ **Obama and Pelosi in Minnesota:** The President and Speaker of the House attend a dinner for the Democratic Congressional Campaign Committee.



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Minnesota Vikings at the Green Bay Packers’ Lambeau Field



▶ **U.S. Senate candidates debate in Florida:** Republican Marco Rubio, Democrat Kendrick Meek, and the Independent, Governor Charlie Crist, square off in Tampa.

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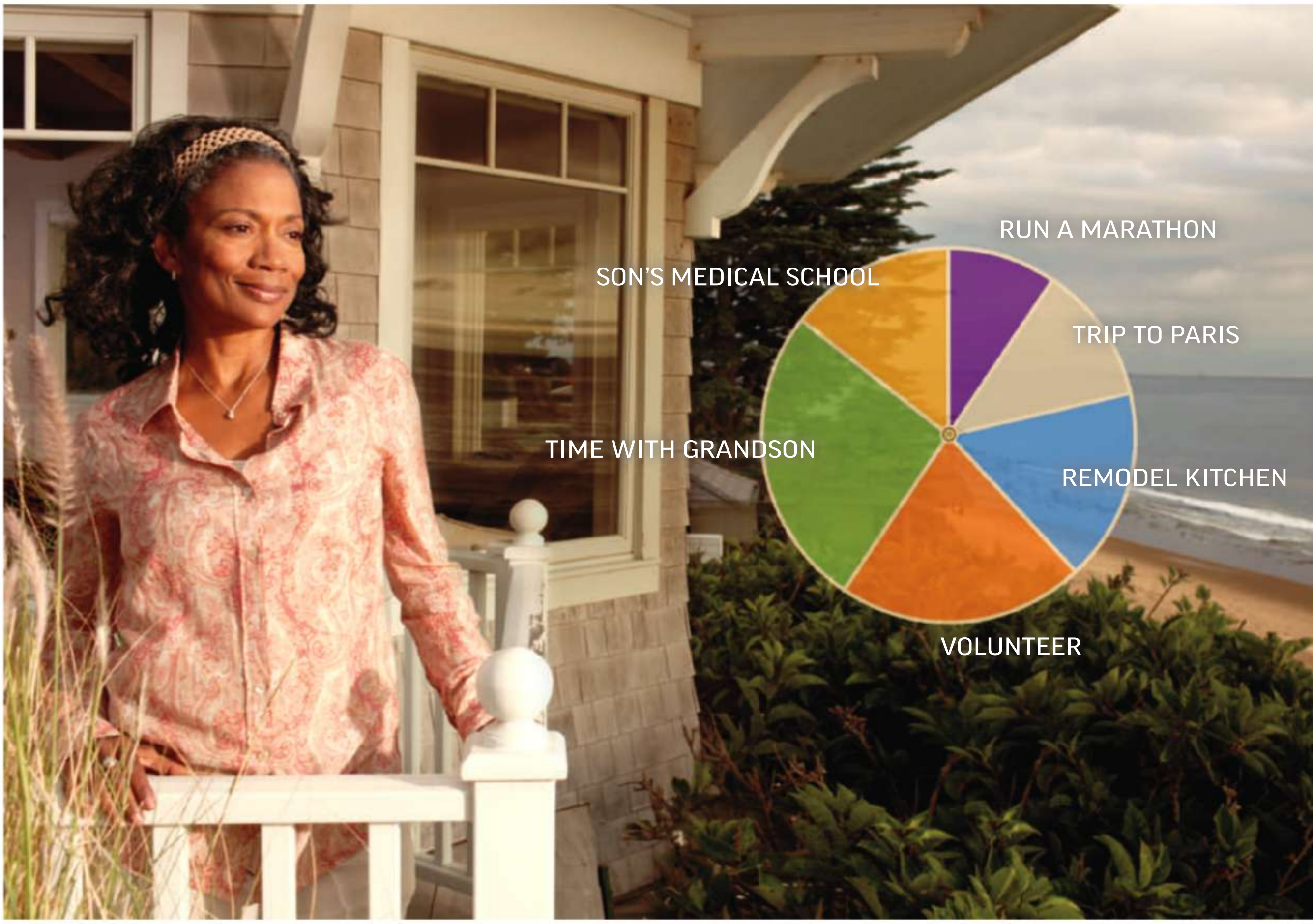
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Hooray for Hăoláiwù!

▶ **China goes Hollywood, hoping film investments will help build its own entertainment industry**

▶ **Trying not to be the latest "intelligent people investing money in unintelligent ways"**

Han Sanping is a big fan of actor Will Smith. After entertaining Smith in Beijing two years ago, the chairman of **China Film Group** found a different way to keep up with Smith's filmmaking efforts. State-run China Film contributed $5 million to help finance a remake of *The Karate Kid*, produced by Smith and starring his son Jaden. Han's mogul turn was a hit. The film, distributed by **Sony**'s Columbia Pictures, grossed more than $356 million in worldwide ticket sales and was a huge hit in China.

For Hollywood, always a dream factory powered by other people's money, the People's Republic of China offers huge potential as both a funding source and a market. On Sept. 26, **Orange Sky Golden Harvest Entertainment**, a Hong Kong-based film company, paid $25 million for a 3.3 percent stake in **Legendary Pictures**, the maker of such hits as *The Dark Knight* and *Inception*. Meanwhile, China's new class of millionaire entrepreneurs is financing locally made films. Hollywood executives are even taking meetings with Chinese toy companies eager to take their creations to the big screen.

"It's a largely untapped market," says Clark Hallren, managing partner at Los Angeles-based financial advisory firm Clear Scope Partners. "There appears to be great promise there and a tremendous amount of capital. Similar to how those in search of capital once focused on the Middle East, the same dynamic seems to be occurring with China."

The dealmaking to date has been more a trickle than a waterfall. Chinese investors weighed bids for **Miramax** and debt-plagued **Metro-Goldwyn-Mayer** when those studios were put up for sale in the past year, but they didn't bite, says attorney Schuyler M. Moore, a partner at Stroock & Stroock & Lavan in Los Angeles. Their activity may pick up, however, as Chinese officials become more comfortable with the ways of Hollywood.

What Chinese investors possess already is plenty of capital for the right film project

"Chinese investors are very sophisticated and have been contemplating the kinds of investments they want to make," says Charles "Skip" Paul, a longtime Hollywood executive and a senior adviser to investment bank Centerview Partners. Paul negotiated the 1986 agreement with the Chinese government that opened the country to limited imports of foreign-made films. He also advised Orange Sky in its Legendary deal and travels to China every six weeks to meet with potential investors.

The Chinese government hopes to use its investments to gain the

MANDARIN TYPOGRAPHY BY JULIUS HUI AND SAMMY OR; PHOTO: THOMAS MCCONVILLE/GETTY IMAGES

technical and creative knowhow the country needs to aggressively build its film industry. In the next three to four years the number of screens in China will increase to about 13,000 from 8,000 today, according to John P. Wilmers, chief executive officer of **Ballantyne Strong**, which makes digital movie equipment. The U.S. has about 39,000 screens. China is the largest non-U.S. market for **Imax**'s big-screen theaters, with 37 built and an additional 59 scheduled to be added by 2013. In 10 years, says Imax CEO Richard L. Gelfond, China may be the largest exhibition market in the world.

"They want to be market leaders in producing films," says Doug Belgrad, president of Columbia Pictures, which made *The Karate Kid* mostly in Beijing. The Chinese are using their financial relationships to get teaching moments whenever they can. The Columbia crew, for instance, showed the local Chinese production team how to more quickly upload film from daily shoots to be viewed online, says Belgrad.

That level of involvement sets Chinese investors apart from others who have come to Hollywood offering cash, says Clear Scope's Hallren. "I don't think this will be the next case of intelligent people investing money in unintelligent ways," Hallren says.

What China possesses already is plenty of capital for the right project. Sheng Boyu, a 30-year-old real estate developer, put up $50 million to help finance *Double Lives*, a film about a modern-day treasure hunt starring Pierce Brosnan being filmed in China. "There is money if you know how to navigate the landscape," says Dan Mintz, CEO of Beijing-based **Dynamic Marketing Group**, which distributes and markets American- and Chinese-made films in China. Mintz says he raised $100 million in China, "and we could go higher" to invest in films made or distributed there.

The obstacle for outsiders, he says, is that the government favors Chinese-made movies and continues to impose a limit of 20 foreign films a year that can be shown in the country. With investors who are Chinese, some films can reach the market without counting as part of the 20-slot quota. And there may be other benefits: When Mintz released *The Founding of a Republic*, a film his company financed with China Film Group, he said the government ordered rival films out of many mainland theaters.

China's potential has sent dealmakers descending on Beijing. **Goldman Sachs** is advising the **Chinese Investment Corp**. sovereign fund on film investments, according to two knowledgeable Hollywood financiers. **Deutsche Bank** has stepped up its efforts in China to focus more on entertainment deals as well, says Brian C. Mulligan, vice-chairman of Deutsche Bank Securities' media and telecommunications practice in Los Angeles, which advised Legendary in the Orange Sky deal.

Still, investing in Hollywood hasn't always turned out well for those writing the checks. "Some will benefit from smart and knowledgeable advisers," says Amir Malin, founder of New York-based private equity firm Qualia Capital and former CEO of film studio Artisan Entertainment. "Others will be taken on an endless merry-go-round of Hollywood premieres and empty financial returns." —*Ronald Grover and Michael White, with Eva Woo*

The bottom line *Hollywood is looking to China for money to help produce films. The Chinese want those relationships to bolster their own movie industry.*

2.2

BILLION DOLLARS

Wal-Mart Stores' planned spending on new stores in fiscal 2012. The retailer will open as many as 205 stores in the U.S., including up to 40 smaller locations in urban areas.



Graduation for Chinese pilots at Binzhou University

GUO ZHIHUA/IMAGINECHINA

Global Airlines

So Many Asian Flights —And So Few Pilots

▶ Fast growth in air travel has airlines scrambling for cockpit crews

▶ "This is going to last for a while ... it takes time to produce a good pilot"

Asia's economies are booming, and so is demand for air travel across the region. Flying for business and pleasure is increasingly affordable for the combined 1.1 billion middle-class residents of China and India. All those potential fliers have translated into new orders for aircraft makers–Asia-Pacific airlines will buy about 8,000 planes worth $1.2 trillion over the next 20 years, according to **Airbus.** Less noticed is another group of beneficiaries: Asian pilots.

The International Civil Aviation Organization forecasts that airlines worldwide will need an average of 49,900 new pilots a year from 2010 to 2030 as fleets expand, yet current annual training capacity is only 47,025. The shortage is likely to be acute in Asia as three big carriers trying to capitalize on the region's rising prosperity, **Cathay Pacific Airways**, **Qantas Airways**, and **Emirates Airline,** await deliveries of

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about 400 planes. That's already sparking bidding wars for cockpit crews, with Emirates offering tax-free salaries and four-bedroom villas for captains and **AirAsia**, the region's biggest budget airline, providing tuition-free training for airmen willing to join its ranks.

"It's a major issue and will be a big challenge to the industry's growth," says Binit Somaia, a Sydney-based analyst for the Centre for Asia Pacific Aviation (CAPA). "Even if you can find the pilots, you have to pay top dollar for them because they are so scarce."

This year the Asia-Pacific region's carriers ordered 133 commercial jets with more than 100 seats each, or 23 percent of new orders globally, according to aviation forecaster Ascend Worldwide. With the economies of China and India expected to grow at more than double the global rate in the next few years, Asian carriers are likely to continue expanding. One result: "There will be a shortage of pilots, and this is going to last for a while because it takes time to produce a good pilot," says the president of the Airline Pilots Association of the Philippines, Elmer Pena. In July and August, **Philippine Airlines** canceled flights and rebooked passengers after losing 27 pilots to higher-paying jobs abroad.

Pilot demand in Asia contrasts with the U.S., where 4,500 airline pilots are on furlough, according to figures compiled by Kit Darby, a retired United Airlines pilot now running an Atlanta-based consulting firm. That may not last long, however, since the global fleet of cargo and large passenger planes will double, to nearly 32,000, by 2028 from 15,750 last year, according to Airbus. The major U.S. airlines are expected to hire more than 40,000 pilots in the next 12 years, says Louis Smith, president of FltOps.com, which provides career counseling services and sponsors job fairs. "I believe one can expect serious shortages among the foreign carriers who can't afford to pay what it takes to attract qualified pilots," Smith says.

Emirates, which is expected to spend up to $28 billion on expansion through 2017 and has more than 200 planes on order, plans to recruit 250 pilots this year. The airline says it will double the number of pilot hires in 2011. To help find new crew members, Emirates has expanded its recruiting efforts in Houston, Madrid, and Singapore.

Cathay Pacific, Hong Kong's biggest carrier, will recruit 1,000 people, including crew, says Chief Operating Officer John Slosar. Indonesian carrier **Garuda Indonesia** placed newspaper advertisements this summer seeking pilots "fluent in English and of good character." And Jetstar Airways, the budget arm of Qantas, plans to recruit 120 pilots by next summer.

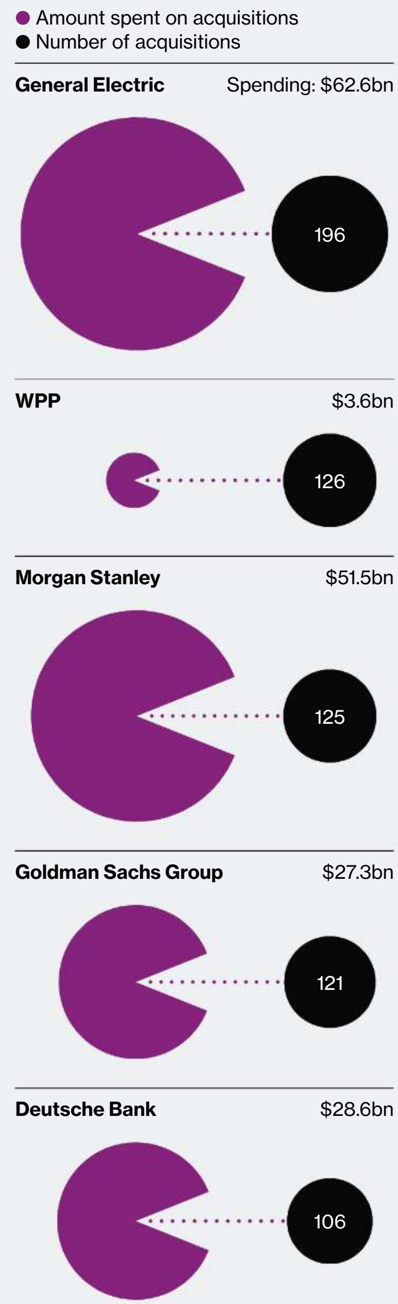
Some airlines aren't waiting for qualified talent to walk in the door. **Singapore Airlines** and AirAsia, based near Kuala Lumpur, have each set up their own tuition-free training academies. Singapore Air's flying school turns out about 150 cadet pilots a year, while AirAsia's facility trains as many as 500 annually. AirAsia's graduates must stay with the budget carrier for five years, Chief Executive Officer Tony Fernandes says. Other flight schools also are opening to help meet the demand. CAPA, for one, is investing at least $125 million to build an aerospace university in India that can train about 300 pilots a year, Somaia says.

The expected pilot shortage, plus hiring by a new crop of regional budget carriers, could push wages higher. "There is a misconception that low-cost airlines pay lower salaries," says Tony Davis, CEO of budget carrier **Tiger Airways Holdings**, part-owned by

Acquisitions

Who Bought the Most

Internal growth may be the Holy Grail for business, but acquisitions remain a big source of corporate growth. Bloomberg ranked large public companies ($5 billion-plus) by the number of pending and completed deals since September 2005, excluding private equity transactions, multibuyer deals, and canceled buyouts.



DATA: BLOOMBERG



Geithner pushes for a stronger yuan page 34 ▶

Singapore Air. "We couldn't do that in a competitive market."

Basic pay for Singapore Air captains flying twin-aisle Boeing 777s or Airbus A330s begins at 9,300 Singapore dollars ($7,138) a month, excluding allowances, says P. James, president of the Air Line Pilots Association of Singapore. Pilots also earn a productivity allowance of as much as $2,917 for flying 70 hours a month.

Emirates offers a starting monthly salary of 34,410 dirhams ($9,368) for captains. That excludes benefits such as hourly flying and productivity payments. Its other perks include a tax-free basic salary, profit sharing, villas for captains, and free dry cleaning of uniforms. Those incentives help attract candidates to an increasingly demanding job, says Barry Jackson, president of the Australian and International Pilots Assn., who has been a pilot at Qantas since 1987. "Young people these days prefer to become doctors or lawyers," Jackson says. "This sort of career path is becoming less desirable." —*Chan Sue Ling*

The bottom line *As Asian air travel soars, the demand for pilots will likely outstrip supply. Some airlines are offering perks to recruits, including free training.*

Autos

Luxury Cars Are Neck And Neck in the U.S.

▶ **Longtime leader Lexus has ceded ground to Mercedes and BMW**

▶ **"The aspiration to own a Lexus has diminished"**

Jennifer Haisha, of West Bloomfield, Mich., gave up her Infiniti two years ago for a black Mercedes E-Class with a monthly lease of only $416. "My payments were unbelievable," says Haisha, 57, who works in retail. "I compared them to the [Cadillac] CTS and other cars. [Mercedes] gave me the best deal."

Haisha's good fortune is bad news for Lexus, the luxury car leader in the U.S. since 2000. Lexus has been tarnished by a string of much-publicized quality problems at its parent, **Toyota Motor**. That's helped pull the brand's growth rate below the industry average, allowing German rivals **Mercedes-Benz**, a unit of **Daimler**, and **BMW** to gain ground, and—just maybe—grab the American luxury car sales crown.

Mercedes, after selling more vehicles than Lexus in the U.S. in September, finished the third quarter only about 2,700 sales shy of overtaking the Japanese brand. "The aspiration to own a Lexus has diminished, the aspiration to own a Mercedes has increased," says Art Spinella, president of CNW Marketing Research, which surveys customers.

Restraining price hikes has helped Mercedes close the gap. The average price paid for a vehicle in the U.S. has risen 12 percent since 2006, according to Edmunds.com, an auto pricing website. Mercedes' price inflation over the same period? A mere 1 percent. Explains Ernst Lieb, chief executive officer of Mercedes' U.S. unit: "We still have a price premium over our competitors—we always will. [We're] just closer" to their prices now.

The aggressive pricing is evident in Mercedes' entry-level C-Class sedan, the only vehicle in its lineup with a list price less than $35,000. The average monthly lease payment for the C-Class (about the size of a Toyota Corolla) in September was $479, with some deals as low as $349, according to Edmunds.



German rivals are gaining on Lexus

FROM TOP: U.S. TREASURY DEPT.; ILLUSTRATION BY DAVID PARKINS.

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"That's a very, very compelling argument," says Bernie Moreno, a Mercedes dealer near Cleveland. "It's not a lot more money to get a luxury car."

For this year's first nine months, Lexus' U.S. sales rose 8.7 percent, to 162,438, vs. the same period a year earlier. Mercedes narrowed the gap, with deliveries rising 18 percent, to 159,729 cars and SUVs. U.S. sales for BMW, the world's largest luxury carmaker, increased 9.2 percent, to 157,464. (Sales don't include Daimler's Smart and BMW's Mini small cars or Mercedes Sprinter vans.)

"Clearly, the [Toyota] recalls had a lingering impact on the sales of Lexus," says Jesse Toprak, vice-president of industry trends at researcher TrueCar.com. "I think what's also happening is Benz has had aggressive lease deals this year."

Mercedes also has benefited from new products, beginning in 2009 with the GLK, a small SUV, followed by the ninth-generation E-class midsize sedan. Over the last three years as it introduced new vehicles, Mercedes pushed dealers to invest $1.4 billion to update their stores.

The carmaker is getting better at keeping customers. It ranked highest in customer retention in J.D. Power & Associates' most recent study last year, up from fourth in 2008. Lexus, meanwhile, slipped to fourth from third. The German automaker also persuaded more Lexus owners to try Mercedes, Edmunds data show, while the number of Mercedes customers trading in for a Lexus fell.

BMW also expects momentum to grow next year because of added production of its X3 SUV and a redesigned 5-series sedan. Mercedes is "very aggressive this year," says Jim O'Donnell, president of BMW's North American unit. "I think they see this as their opportunity that won't be available to them in the next few years because of product changes" at rivals.

Brian Smith, U.S. vice-president of Lexus brand sales, remains confident. "I don't think we're going to lose leadership this year, but time will tell." To blunt the competition, analysts expect Toyota to ramp up yearend discounts. "We'll probably see some pretty impressive incentives," says Joe Barker, an analyst with IHS Automotive. "The month of December likely will be a wonderful time to buy a luxury automobile." —*Tim Higgins*

The bottom line *Toyota's quality problems—and aggressive pricing by rival Mercedes—have fueled market share losses at Lexus.*

JAN PETTER LYNAU/SCANPIX/ZUMAPRESS

Media

One Publisher Applauds As Its Print Ads Wither



▶ **Norway's Schibsted has jumped into online classified ads globally**

▶ **A Web buyout was costly, "but very soon annual profits surpassed that"**

Like newspapers almost everywhere, Norwegian dailies *VG* and *Aftenposten* have watched their once-lucrative classified advertising sections shrivel as readers defect to websites where they can browse and post ads for free. That doesn't bother the papers' publisher, Oslo-based media group **Schibsted**. It also owns the website that lured away most of the classified ad business—and that site is more profitable than print ads ever were. "We weren't afraid to cannibalize ourselves," says Chief Executive Officer Rolv Erik Ryssdal about the group's decision in 1999 to spin off an online business called FINN.no that competes directly with its papers.

Schibsted, founded in 1839, has taken that successful strategy on the road. Its online classified business has expanded worldwide, with sites in 22 countries listing everything from real estate in Malaysia to cars in Italy to job openings in Argentina. On Sept. 22 the group bought control of France's No. 1 classified site, leboncoin.fr, from a former venture partner, in a deal that values the site at $540 million. Schibsted is now the global No. 3 in online classifieds, behind **eBay** and **Craigslist**. Revenues from its classified ad sites hit $245 million during the first six months of this year, with profit margins at some of its best performing sites as high as 60 percent.

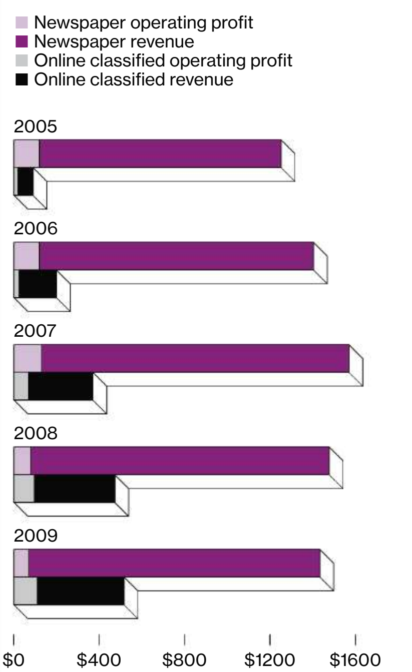
"Schibsted is probably the smartest media company in the world right now," says Peter Zollman, founding principal of AIM Group, a Florida-based media consultancy. "They have been willing to jettison print, where appropriate, and they are willing to invest, where most media companies now are hunkered down."

U.S. newspapers' ad revenues plunged to $24.8 billion last year from $48.6 billion in 2000, according to the Newspaper Association of America. Classified ads have taken the worst hit of any ad category, declining 68 percent since Craigslist began rolling out its business nationwide in 2000.

American newspapers have long complained they can't compete against Internet-based Craigslist, whose founder, Craig Newmark, has said he doesn't care about making profits. Yet Schibsted's business model isn't that different from Craigslist's. Both companies charge nothing for most listings. While Craigslist charges for ads in some premium categories such as apartments in Manhattan, Schibsted asks users to pay a surcharge to give their listings more-prominent placement. Schibsted's classified sites also carry display ads from businesses, something Craigslist doesn't do. (The Norwe-

New Media's New Profits

Sales and operating profits for Schibsted's print newspapers and online classified businesses (in millions of dollars)



DATA: SCHIBSTED

gian company also owns job-search and automotive sales sites that charge businesses for listings.) Because operating costs are minimal, "the yield is just enormous," says Frédéric Filloux, a Paris-based media consultant who worked for Schibsted from 2007 to 2009.

Craigslist doesn't disclose financials, but AIM Group estimates its annual revenues at $120 million. If accurate, that's less than one-fourth the revenues of Schibsted's online sites worldwide (including its non-classified online businesses). While online ad sites generate only a small part of Schibsted's $2 billion annual sales, their average 24 percent operating margins helped the company eke out $67 million in profits last year, offsetting weaker performance from its print holdings, which include the *20 Minutes* free dailies in France, Spain, and Switzerland.

It may be too late for other publishers to follow Schibsted's example. Going up against established competitors is tough—as Schibsted discovered in 2003, when it set up a classified ad site in Sweden but couldn't make headway against a local classified ad site called Blocket.se. Within months, Schibsted closed its site and bought Blocket for $27.3 million. "The acquisition price was considered to be high, but very soon the annual profits surpassed that," says Ryssdal, who at the time was running the company's Swedish operations.

Online auction giant eBay has followed a similar strategy in Europe. In 2004 and 2005, it acquired the top classified ad sites in Germany and Britain and now is the market leader in both countries. But eBay has stumbled in the U.S., where it didn't launch a classified business until 2008 and has failed to gain ground against Craigslist.

Both Schibsted and eBay say their businesses have plenty of room to grow, especially outside the U.S. "We've only scratched the surface," says Jacob Aqraou, general manager of the global eBay Classifieds Group. He says traffic on eBay's German site is "exploding" as the company rolls out mobile applications. And Schibsted is pushing for growth in emerging markets such as the Philippines, where it recently set up a classified site. —*Carol Matlack*

The bottom line *While many publishers bemoan the loss of print ads, Norway's Schibsted has developed a more profitable global business in online classifieds.*



Retailing

Why the Deals Are Hit-or-Miss at Outlet Malls

▶ With luxury inventories tighter, outlets must stock less tony goods

▶ "You don't have nearly the quality you had in the recent past"

As Jennifer Mason searched the racks at a **Neiman Marcus** Last Call outlet in Virginia this month, she was hoping to find Gucci or Prada as she did last year. No deal. "I've gotten a little skeptical," says Mason, who owns a printing supplies company and frequents the Potomac Mills mall outside Washington. "It doesn't feel like it's really deals."

Not long ago, the upscale outlet was a secret weapon for fashionistas seeking leftover Dolce & Gabbana dresses at 75 percent off. Over 30 years ago, almost all the clothes at upscale outlets came from the main locations of tony retailers like **Nordstrom**. Now as little as 10 percent is made up of designer goods actually sold at upscale retail stores. That means fewer bargains for chic-hunters like Jennifer Mason.

Increasingly, merchandise is made specifically for the outlets and sold nowhere else at full price (even though it may be made by a top brand like Calvin Klein), says retail consultant Steven Dennis, who dubs the phenomenon "faux clearance." Explains Goldman Sachs analyst Adrianne Shapira: "The perfect storm is when there is excess inventory and these guys are flush with great buys. That has reversed."

One reason: It's simply harder for outlets to get their hands on the real deal, Dennis says. U.S. department stores slashed inventory as consumers pulled back on spending over the past two years, leaving less to end up in the outlets. Inventories at **Saks**, for instance, were worth $649.2 million on Jan. 30, 2010, down 24 percent from two years earlier. Meanwhile, competition for the best goods has grown as outlets multiply and online purveyors such as **Gilt Groupe**, which offers discounted luxury goods during limited-time "flash sales" online, entered the market.

"You don't have nearly the quality you had in the recent past and you don't have the degree of discounts," says Dennis, founder of Sageberry Consulting and a former Neiman Marcus senior vice-president. "It's hard to believe all of these players can operate 50 to 100 outlets successfully. There's going to be a shakeout."

The outlet concept took off in the 1970s, when **VF**, the world's biggest apparel maker, began letting shoppers rummage through cardboard boxes of its excess hosiery at its

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mills, says Linda Humphers, editor-in-chief of *Value Retail News*. About the same time, Nordstrom opened the first Rack in the basement of its Seattle flagship store to get rid of its leftover shoes. Outlet malls proliferated in the early 1990s. By 2008, the U.S. had almost 13,000 stores in outlet centers, and everyone from **Anne Klein** to **Kenneth Cole** to Elie Tahari had hopped on the trend.

Outlet shoppers found plenty to buy that year, because the onset of the recession left upscale merchants holding huge stocks of luxury goods—which they unloaded at outlets at deep discounts. Then fashion overstock began to dry up as retailers bought less, forcing department stores to fill their outlets with faux clearance.

At Saks' Off 5th stores, 10 percent to 20 percent of the merchandise is clearance from Saks' full-priced stores, about 20 percent is Off 5th store-label goods, and most of the rest is made for the chain by vendors, says spokeswoman Julia Bentley. The clothes are in-season, she adds, and sold at substantial savings. Ginger Reeder, a spokeswoman at Neiman Marcus, declined to comment about the selection at its Last Call stores.

About 20 percent to 25 percent of the merchandise at Nordstrom's more than 80 Rack outlets is clearance from its full-price department stores, says spokesman Colin Johnson. The rest is mostly vendors' excess inventory. "Little" is made-for-outlet, says Johnson. The challenge is obtaining the best quality merchandise, says Blake Nordstrom, the retailer's president: "We're working on that."

Sales at Rack locations open at least a year fell 2.4 percent in August and September, compared with a 1.7 percent gain a year earlier. At Saks' Off 5th stores, performance was below the company average for the second quarter, a reversal from a year ago.

Saks said last week it was closing its Off 5th store in Reno, Nev., because the store was underperforming. Similar disappointments may follow if shoppers like Mason head back to full-price stores seeking the genuine article. "Tomorrow," she says, "I think I'm going to get the real clothes." Ⓑ —*Cotten Timberlake*

The bottom line *Outlet stores selling designer goods have been forced to stock less glitzy merchandise as excess luxe inventories are harder to find.*

Briefs

by Caroline Winter

Facebook and Zynga
Discouraging pre-IPO share sales



Facebook and Zynga Game Network have begun levying fees of $2,500 and $6,000, respectively, on private sales of company shares, a move legal experts say is meant to discourage employees and investors from unloading their stock before an initial public offering. Zynga Chief Executive Officer Mark Pincus (right) said in April that the maker of popular online video games was considering imposing limits on transactions, citing concern over leaks of inside information. One reason private companies discourage such sales is that the SEC requires those with more than 500 shareholders to disclose financial data that some companies would rather keep private until they pursue an IPO.

General Motors
Defending the Volt's status

GM is defending the green credentials of its low-emissions Chevrolet Volt against accusations that the vehicle is a hybrid and not a true electric car as billed. The auto industry press says the $41,000 Volt, which will go on sale in November, should be classed as a plug-in hybrid because it sometimes uses gasoline to power the wheel system. GM says it has declined to share details of the car's technology because it is awaiting patent approvals.



Gap
Scrapping its redesigned logo

Gap shelved plans to introduce a new logo after hundreds of people left disparaging comments about the redesign on the company's Facebook page. The clothier posted an image of the new logo on its website on Oct. 4 and had intended to roll it out in marketing campaigns starting next month. The change was meant to underscore the brand's evolution from "classic, American design to modern, sexy cool," according to a Gap spokeswoman. The retailer, which has suffered declining sales at North American stores for six straight months, will stick with it's 20-year old look for now.

Alibaba and Microsoft
Teaming up on a new search engine

China's No. 1 e-commerce player, Alibaba, has joined forces with Microsoft to launch a new Internet search engine service called Etao, challenging the dominance of market leader Baidu. Alibaba, of which Yahoo! owns about 40 percent, released Etao for public testing on Oct. 9. The site uses Microsoft's Bing technology and aims to drive traffic toward Alibaba's retail website, Taobao, by giving Taobao's listings preference in search results. Etao will, however, likely cannibalize Yahoo's Chinese website, which has seen its market share fall into the low single digits. In related news, the former chief operating officer of Baidu was appointed vice-president of Taobao on Oct. 12.

News Corp.
U.K. media hopes to halt BSkyB bid

$12.8 BILLION

U.K. newspapers including *The Daily Telegraph* and *The Guardian* have joined the BBC in asking the government to block a bid by Rupert Murdoch's News Corp. to acquire the 61 percent of British Sky Broadcasting group it doesn't already own. They say the takeover of the country's biggest pay-TV operator would give News Corp. too much control over British media outlets. In June, News Corp.'s $12.8 billion bid for BSkyB was rejected as too low. A final price won't be negotiated until regulatory approval is received.

On the Move

Blockbuster **Search launched to replace Jim Keyes as CEO** ● **Eastman Kodak** **Antoinette P. McCorvey appointed CFO** ● **Lazard** **Former JPMorgan Cazenove CEO Naguib Kheraj named deputy chairman**

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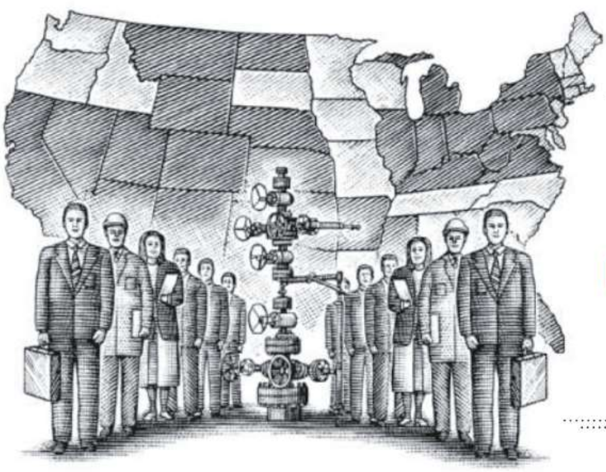
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105,000 NEW JOBS ▲

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WHAT YOU NEED TO KNOW ABOUT NATURAL GAS AND JOBS CREATION.

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The consensus is clear.

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Contents ▶ Geithner gets tough with Beijing 34 ▶ Joe Biden's thankless mission: Selling the stimulus 36 ▶ Charlie Rose talks to the Treasury Secretary 37 ▶ Financial regulatory reshuffling 38 ▶ The CFTC is under siege by lobbyists 39 ▶ A guide to Beltway-Speak 40 ● Edited by Paula Dwyer

Total private-sector pension shortfall: $393 BILLION

Potential unfunded state pension liabilities: $3 TRILLION

74% Portion of federal civilian workers' retirement the government pays

"THERE IS JUSTIFIABLE PENSION ENVY HERE, BUT IT GOES TOO FAR" —ALICIA MUNNELL, CENTER FOR RETIREMENT RESEARCH

Top 10 average pension payouts to current state and local government retirees:

2008, IN THOUSANDS OF DOLLARS

53.2	NEW YORK CITY TEACHERS
46.3	HOUSTON FIREFIGHTERS
40.9	NEW JERSEY POLICE & FIRE
38.9	ARIZONA PUBLIC-SAFETY PERSONNEL
38.6	WASHINGTON STATE POLICE & FIRE
37.9	NEW YORK STATE & LOCAL POLICE & FIRE
37.8	CHICAGO TEACHERS
37.6	UNIVERSITY OF CALIFORNIA
35.9	NEW YORK STATE TEACHERS
35.7	CONTRA COSTA (CALIF.) COUNTY EMPLOYEES

THE NATIONAL AVERAGE: $22,780

19.6 MILLION current state and local government workers

7.7 MILLION current state and local government retirees

16 STATES INCREASED INDIVIDUAL RETIREMENT CONTRIBUTIONS FOR GOVERNMENT EMPLOYEES OR CUT BENEFITS FOR NEW HIRES

$3.04 PER HOUR contribution toward retirement by state and local employers

92¢ PER HOUR contribution toward retirement by private employers

DATA: UNIVERSITY OF ROCHESTER, NORTHWESTERN UNIVERSITY; CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE; U.S. CENSUS BUREAU; EMPLOYEE BENEFIT RESEARCH INSTITUTE; MILLIMAN; U.S. LABOR DEPT.

The Political Rumble Over Public Pension Costs

▶ **Unfunded retirement benefits have become an election issue, and unions are fighting back**

▶ **"It's surprising our teachers, police officers, and firefighters are Public Enemy No. 1"**

If anyone fits the profile of a San Francisco Democrat, it's Jeff Adachi. In 2004 the elected public defender volunteered to officiate at ceremonies of same-sex couples during the city's short-lived attempt to legalize gay marriage. This year, though he is running unopposed, he is drawing scorn from fellow Democrats for spearheading a ballot proposition that would force city workers to pay more of their growing pension and health-care costs. "How dare you take it off the backs of city workers," Leland Yee, a Democratic state senator from San Francisco, thundered into a microphone at an Oct. 5 protest rally.

Taxpayers face as much as $3 trillion in unfunded state workers' retirement liabilities, according to a study by the University of Rochester and Northwestern University. As pension costs soar, they're igniting political fights nationwide. Voters in nine California cities and counties will decide next month whether to curb benefits for current or retired police officers, firefighters, librarians, and janitors.

Beyond November, the cost of government pensions could become one of the defining policy issues of the coming decade. Civil servants are trying to protect what they believe is a social contract with taxpayers, whose retirement benefits are often far less generous. (State and local governments paid $3.04 per hour toward each employee's retirement in 2007, according to U.S. Labor Dept. data. Private employers paid 92¢ per hour.) At the same time, elected officials and taxpayers are desperate to find reductions in state and local budgets without further cutbacks in services.

More than 80 percent of the nation's 27 million state and local government workers and retirees are covered by public pensions. The median state plan had enough money to pay just 76 percent of its obligations as of



Adachi is spearheading a public-pension reform initiative in San Francisco

JEFF CHIU/AP PHOTO

Aug. 20, according to data compiled by Bloomberg. Six cities–Boston, Chicago, Cincinnati, Jacksonville, Fla., Philadelphia, and St. Paul, Minn.–will run out of pension money by 2020, according to the Rochester and Northwestern study released Oct. 12. "The bills that weren't paid a decade ago are coming due," says Patrick Murray, director of the Monmouth University Polling Institute in West Long Branch, N.J.

The Service Employees International Union is dispatching members to town hall meetings to defend pensions. They hand out literature arguing that 7 out of 10 retired public employees receive less than $30,000 a year in pension benefits. The American Federation of State, County, and Municipal Employees is calling politicians "deadbeats" for trying to walk away from promised pensions. "This is deferred compensation that is owed to workers," says Steven Kreisberg, director of collective bargaining for AFSCME, which has 1.6 million members. "Some of the politicians demagoguing on this issue are losing sight of their moral and legal responsibility."

While unions once counted on Democrats for support, gubernatorial candidates Jerry Brown in California and Andrew Cuomo in New York are vowing to get tough on pensions. The fight has turned nasty in California, where Brown's opponent, Republican Meg Whitman, is proposing to exempt public-safety workers from her proposal to convert public workers to 401(k)-style retirement plans. That prompted a Brown associate, who suspected Whitman of cutting a backroom deal to get an endorsement, to call her a "whore" in a recording posted online by *The Los Angeles Times* on Oct. 7. Darrel Ng, a spokesman for Whitman, says she proposed her pension reform five months before she won an endorsement from Los Angeles police. \Brown apologized to Whitman in a televised debate.

"This is deferred compensation that is owed to workers," says one union official

Already this year, 16 states have required public employees to pay more into retirement plans or cut benefits for new hires. Nine states increased the number of years new hires must work to earn full retirement benefits. Two states, Missouri and Illinois, raised the retirement age to 67. California's new budget requires current state workers to contribute more toward their retirement and rolls back new hires' pension benefits to 1998 levels.

U.S. Representative Darrell Issa (R-Calif.), who would chair the House's oversight committee if his party regains control in November, is drafting a report about underfunded state and local pension plans. Spokesman Kurt Bardella says Issa is concerned "that calls for a federal bailout to avert a fiscal disaster for state and local governments may be just over the horizon."

Fueled by reports of six-figure retirement benefits for firefighters, city managers, and other civil servants, public sentiment is turning hostile. Seventy-six percent of Californians polled in June said public pensions were a big problem or "somewhat of a problem," according to a poll by the Pew Center on the States and the Public Policy Institute of California. In Illinois, 83 percent of respondents answered the same way, as did 79 percent in New York.

"Pension envy" among private-sector workers is justifiable in some cases but goes too far," says Alicia Munnell, director of the Center for Retirement Research at Boston College. The average annual benefit for public retirees was $22,780 in 2008, according to the center's study of the 126 largest public retirement plans. "It's surprising our teachers, police officers, and firefighters are Public Enemy No. 1," Munnell says.

Adachi, 51, says pension obligations are forcing city cutbacks in programs such as drug-treatment centers and after-school activities. "All of the progressive programs that we fought so hard for over the years are getting crowded out by rising pension costs," he says.
—Ben Elgin, Chad Terhune, Christopher Palmeri, and Dunstan McNichol, with Patrick O'Connor

The bottom line *Battles over the cost of public pensions could dominate government at all levels for the next decade.*

Currency

Geithner's Bold Push For a Stronger Yuan

▶ The Treasury Secretary is using IMF voting rights as leverage

▶ "There is a sense that everyone else is hiding behind the Americans"

Treasury Secretary Timothy Geithner is known for not picking fights he can't win and keeping his differences with other countries private. At the annual meeting of the International Monetary Fund on Oct. 8-9, he shifted course on both counts.

After months of publicly supporting China while privately push-

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"OCHSNER STANDS AT THE FOREFRONT OF HEALTHCARE IN LOUISIANA. WE'RE PROUD TO STAND WITH THEM.

When the people of Southeast Louisiana seek high-quality care, they turn to a healthcare provider ranked by HealthGrades™ among the top 5% of hospitals in the U.S. for clinical excellence – the not-for-profit Ochsner Health System. I work for GE Capital. For almost 10 years, we've been using our healthcare experience to structure financing solutions that ensure Ochsner has access to state-of-the-art healthcare technology. And by providing access to GE's expertise in healthcare, we're able to assist them in ways that go beyond lending. Who else can do that?"

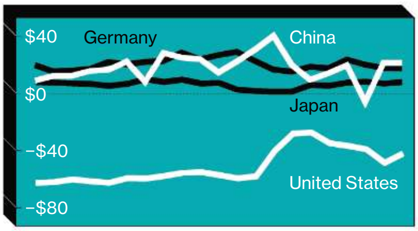
GE Capital is invested in Ochsner Health System.

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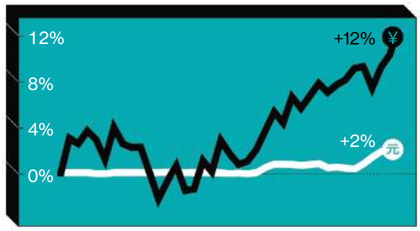
Trade balance (monthly) in $ billions

The U.S. wants trade surplus countries like China, Japan, and Germany to increase domestic demand and reduce reliance on exports



Currency appreciation vs. the dollar

The fast-rising yen is hurting Japanese exports, while China holds its currency fairly steady against the dollar



DATA: BLOOMBERG

ing for a stronger yuan, Geithner used the gathering of finance ministers and central bankers to publicly prod China to move faster. He said China is engaged in a "dangerous dynamic" of keeping its currency undervalued and encouraging other nations to follow suit.

At the same time, Geithner turned a backroom battle over whether to give China and other developing economies greater IMF voting rights into a bargaining chip in the currency debate. If China wants the additional power that the voting rights would confer, he says, China must live up to its commitment to let its currency float more freely.

Geithner's maneuvering is in line with politics at home, where both parties' candidates in this year's midterm elections have slipped anti-China rhetoric into their advertising campaigns. The House on Sept. 29 passed a bill to allow U.S. companies to seek duties on Chinese products to compensate for a weak yuan. The Treasury Secretary is also channeling international ire over a potential currency war if China doesn't let the yuan appreciate. "There is a sense that everyone else is hiding behind the Americans" on this issue, says Jacob Funk Kirkegaard, a senior fellow at the Peterson Institute for International Economics.

Brazil, South Korea, and Thailand have been selling their currencies recently to prevent short-term investors from pushing the value up, harming exporters, and later fleeing in a rush, sending the currency plunging. Japan last month intervened for the first time since 2004 to limit the rise of the yen, which had been at its highest against the dollar in 15 years.

In blaming China and sticking his neck out, Geithner may be setting himself and President Barack Obama up for a fall at the Group of 20 meeting in Seoul on Nov. 11-12, where currencies are on the agenda. Meghnad Desai, professor emeritus of the London School of Economics and a member of Britain's House of Lords, is among economists who see the U.S. making China a scapegoat while ignoring a fundamental shift of economic power to Asia because of fiscal and economic woes in the West. "People still think that the problem with the U.S. is the Chinese exchange rate? Come on. Give me a break," Desai says. If Geithner comes up empty-handed, "the immediate failure will be probably most felt domestically," where confidence in the White House's economic strategy is waning, Kirkegaard says.

Economists such as Desai believe the U.S. needs to jawbone China less and focus more on curbing its long-term budget deficit while spending what's needed in the short term to spur growth. Exporters such as China and Japan, in turn, should encourage more domestic consumption and less saving, these economists say. Geithner agrees with Desai that countries with trade surpluses, such as Germany and China, should reduce their reliance on exports to the U.S. Premier Wen Jiabao said on Oct. 6 that China is addressing both the currency and trade issues—only it's moving gradually to avoid social upheaval. Since June the yuan has appreciated about 2 percent against the dollar.

Keeping the U.S. from meddling in China's domestic affairs may trump any international aspirations, investor George Soros said at an IMF panel on Oct. 9. China is most comfortable in bilateral relations or "what I call state capitalism as opposed to international capitalism," Soros said. "As long as China is the only one following that course, it actually derives very substantial benefits," he said. "But if everybody does it, it's the end of the multilateral system." As Geithner says, that's China's choice. —*Rebecca Christie and Sandrine Rastello*

The bottom line *Treasury Secretary Geithner is turning up the rhetoric in his push to get China to allow the yuan to rise against the dollar.*

Quoted

"Patently untrue."
—U.S. Chamber of Commerce President Thomas Donohue in an Oct. 12 letter to his directors, responding to White House charges that the group buys political ads with money from foreign donors



Elections

Joe Biden, Traveling Salesman

▶ The Vice-President's job is to sell voters on stimulus spending

▶ "It's awful hard to say it's working," Biden says

Three weeks before the midterm elections on Nov. 2, Vice-President Joe Biden's mission is almost impossible: convincing anxious voters that the $814 billion stimulus measure is working in states where Democrats are in danger of losing the most House and Senate seats.

As President Barack Obama's emissary to middle-class voters, Biden in the past month has visited 27 cities in 17 states, stumping for 24 Democratic candidates. Eleven of those stops were in working-class neighborhoods of Pennsylvania and Ohio, where Obama was defeated in the 2008 primaries and where Biden's middle-class roots—he grew up in Scranton, Pa.—may be an asset. "He's certainly got much more of a common touch than

CLOCKWISE FROM LEFT: JOSHUA ROBERTS/BLOOMBERG; DREW ANGERER/THE NEW YORK TIMES/REDUX; BRAD TRENT

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Charlie Rose talks to

Timothy Geithner



The U.S. Treasury Secretary discusses the global recovery, the ongoing American mortgage mess, and tensions with China over its currency

Tell me where the global economy is right now and what you expect to happen next.
The world's now healing. And it's growing. The IMF expects the world as a whole to expand at a rate of a little over 4 percent next year, which is not amazing but much better than we would have thought possible. But that overall number hides huge difference across regions. China, India, Brazil, emerging markets in Asia, Latin America, Eastern Europe, they've got a long period of very rapid growth ahead of them. In Europe and Japan, growth is much weaker. In the U.S., the picture is mixed. Most economists think we're growing at a rate of about 2 percent. But the private forecasters say they expect the economy to strengthen gradually into 2011 and grow at about 3 percent. That's not fast enough for us. We want it to be faster.

We are, in my judgment, a substantial way through the process of healing, of fixing the things that were broken. The financial sector is much less leveraged, we've had a traumatic, huge adjustment in house prices across the country, and private savings rates have already increased quite significantly. Those things are really important for future growth, and they're encouraging. But they do mean that we're not growing as fast as we'd like, and I think Washington's got more work to do to try to provide some support for the economy.

Should there be a national moratorium on foreclosures?
What you're seeing in housing is a national tragedy, still very, very difficult. A lot of people were taken advantage of, and a lot of people were too optimistic about what they could afford. Now you've seen some banks suspend the foreclosure process so they can make sure that they're not causing any injustice to borrowers, and that's very important. But a national moratorium would be very damaging to exactly the kind of people we're trying to protect. We want to make sure we're holding [lenders] accountable. But we also want to make sure that we're not going to make the problem worse.

Tell us about unemployment and why it's at 9.6 percent and why those numbers aren't going down.
Unemployment at 10 percent is still overwhelmingly a reflection of how serious the crisis was, how deep the damage was from this financial panic. And it is going to take time for that to come down. The most important reason why it's so high is because the economy is not growing rapidly enough to provide new opportunities.

Why aren't Americans investing in new factories, in hiring?
Well, they're still scarred by the crisis. They're still a little tentative and cautious. So while they're investing a lot—private investment by American companies grew by an annual rate of more than 20 percent in the first half of the year—you're still seeing businesses waiting to see how strong is growth going to be, and that's the fundamental factor holding back investment and hiring.

So what can you do to reassure them and try to create confidence?
The President, in September, proposed three very important things. First, he proposed a substantial program of investment in public infrastructure. He also proposed two very smart incentives for private investment. One is to make permanent a very generous tax credit for firms that conduct research and development in the U.S. He also proposed, for a one-year period, 100 percent expensing of new capital investments.

If you read the newspapers over the last three months, the impression you have is that all that Tim Geithner does is try to get the Chinese to let their currency appreciate. Where is that today?
China, over the last six weeks or so, has started to let its currency appreciate at a pretty significant rate—about 2 or 2.5 percent. But this is going to be a gradual process. What matters to us is that they continue to let their currency rise. And what we want to do is to maximize the incentives they have to let that process go as far as it needs to go.

What about all this talk of a coming currency war?
No risk of that.

No risk?
There's a lot of capital flowing to [other countries] because they're letting their currencies move. And they're having to work very hard to make sure they're not at an unfair disadvantage with China. ... We want China to play by the rules of the game everybody else plays by.

Are they?
Well ... we'd like them to do more.



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

PHOTOGRAPH ILLUSTRATION BY CREDITTK

Obama does, there's no question about that," says Ross Baker, a political science professor at Rutgers University. Still, Biden, 67, has "a colossal selling job," Baker says. "You're talking about mass merchandising at a time when the value of the product is uncertain."

Trumpeting that millions of jobs were created or saved by the stimulus is a tough sell, Biden concedes. "Less bad is never good enough," he said in an interview aboard Air Force Two on Oct. 8, the day Labor Dept. figures showed that in September the economy was shedding more jobs, with the unemployment rate remaining a stubbornly high 9.6 percent.

52%

Likely voters who say the 2009 stimulus won't help the economy

"It's awful hard to say it's working," Biden said at the end of a campaign swing through Wisconsin, Missouri, and Washington. Trying to sell voters on the idea that unemployment would have been even higher were it not for the stimulus is, Biden said, "like, 'Yeah, but if the dog hadn't stopped would it have caught the rabbit?' "

A 25-page report by Biden, released on Oct. 1, said the stimulus has created or preserved 3.3 million jobs and is on pace to create the intended 3.5 million jobs. The money was allocated quickly and with little fraud, according to the report. Despite that, many Democrats aren't running on Obama's accomplishments like health care, financial regulatory overhaul, and the stimulus because "it's just too hard to explain," Biden says.

A Bloomberg National Poll conducted on Oct. 7-10 showed that 52 percent of 721 likely voters surveyed said they believed the 2009 economic stimulus package will weaken the economy or make no difference. In addition, 44 percent of respondents said the stimulus will make the economy stronger. "People aren't blaming Obama for the fact there's a recession; they're blaming him for the fact that it's going on so long," says James Bennett, 39, an information-technology worker in Tacoma, Wash.

Republicans say the stimulus package didn't live up to Obama's billing. "The massive growth of the federal government didn't result in a similar growth of jobs," Senate Minority Leader Mitch McConnell of Kentucky said in an Oct. 8 statement.

Biden, in the interview, called Republican criticism "phony" and said the September layoffs of 76,700 state and local government workers "shows how wrong they were" to limit assistance to states. More jobs would have been created if Republicans had approved an additional $150 billion that was originally in the stimulus legislation, he added.

—*Kate Andersen Brower*

***The bottom line** Joe Biden has one of the hardest jobs in politics this year: selling his boss's economic stimulus package to voters.*



Protesters await Biden's appearance at a rally in St. Paul, Minn., on Oct. 5



Financial Regulation

A Thrift Regulator Fades (Sort of) into the Sunset

▶ New law protects supervisors who oversaw AIG and IndyMac

▶ "The government never punishes anybody who is in the government"

As Ronald Reagan noted in a 1964 speech, "a government bureau is the nearest thing to eternal life we'll ever see on this earth." In that spirit, consider the Office of Thrift Supervision, targeted for abolition in the Dodd-Frank financial reform law.

The regulator that oversaw such sinking ships as IndyMac Bank, Washington Mutual, and **American International Group** is scheduled to go out of business in July 2011. In truth, OTS is going away in name only. The law devoted 18 pages to making sure none of the 1,000 or so employees (except the director) lose their jobs or have their compensation cut when the agency officially enters the history books.

The new law calls for workers to move to the Office of the Comptroller of the Currency (OCC) or the Federal Deposit Insurance Corp., both of which are assuming some OTS duties. OTS employees may also end up at the new Consumer Financial Protection Bureau. To help smooth the transition, Congress declared that for 30 months after being transferred OTS workers can't be fired or have their salaries cut. The protections show a "complete double standard" by lawmakers who spent much of the crisis calling for bonuses to be cut and heads to roll at the biggest banks and AIG, notes Peter Wallison, a former White House counsel under President Reagan. "The government never punishes anybody who is in the government," he says.

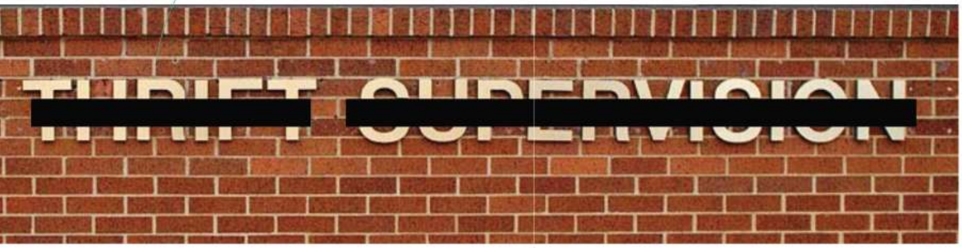
Created in 1989 from the ashes of

FROM LEFT: DAVID JOLES/MINNEAPOLIS STAR TRIBUNE/ZUMAPRESS; PHOTOGRAPH BY KHUE BUI FOR BLOOMBERG BUSINESSWEEK

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OTS staffers (save the director) will not lose their jobs



the savings and loan scandal, the OTS examines mainly small thrift institutions, banks that are required to use the bulk of their assets for home mortgages and other consumer loans. The OTS managed to stay out of the limelight for years until several spectacular failures highlighted its lax oversight. Senator Carl Levin (D-Mich.) and other congressional critics charged the agency with pioneering the practice of "charter shopping"–offering lighter regulation in exchange for regulatory fees.

The banks that OTS supervises lobbied to keep their regulator, arguing that it was singled out because it is a tiny agency overseeing firms that lack the influence of Wall Street banks. The Federal Reserve, they note, supervised **Citigroup** and **Bank of America**, both of which were rescued with double doses of bailout money. "There was plenty of blame to go around, but OTS paid the price," says Camden Fine, head of the Independent Community Bankers of America, which has about 250 OTS-regulated members. Fine says his members now worry that large financial companies will dominate their new regulator and community banks will be "the redheaded stepchild at the family reunion."

The OTS declines to discuss its endgame plans. Officials from other agencies, however, say the OCC, which is part of the Treasury Dept., is mapping out a new division to house former OTS workers and regulate the agency's banks. Acting Comptroller John Walsh, in a late September letter, said the two agencies would hold meetings around the country early next year in an effort to allay banks' concerns. "Our examiners understand the importance of evaluating the condition and future prospects of each institution based on its unique characteristics and performance," he wrote.

For now, the OTS is focusing on more mundane issues. A group of parents has launched a campaign to save its on-site day-care center. Officials from the OCC, the FDIC, and the new consumer regulator are jockeying to take over the OTS's prime headquarters building, a block from the White House. Unlike the OTS's employees, the sign over the door is actually going away.
—*Robert Schmidt and Phil Mattingly*

The bottom line *The Office of Thrift Supervision, scheduled to close its doors in July 2011, will shut down in name only.*

Lobbying

Under Siege at The CFTC

▶ The regulator is no longer a sleepy backwater

▶ "The volume and intensity of the lobbying is unprecedented"

When Peter Y. Malyshev was a graduate student with a part-time job at the Commodity Futures Trading Commission in 2001, he'd walk into the red-brick building near Washington's Dupont Circle and find the lobby almost deserted.

Now a lawyer at Winston & Strawn, with Goldman Sachs among his clients, Malyshev says he's more likely these days to encounter a small regiment of people lining up to get into meetings where they hope to influence the biggest rewrite of Wall Street rules since the 1930s. At times the line of lawyers, bank executives, and hedge fund managers stretches out the door of the small waiting room in the commission's black marble lobby.

The CFTC is no longer the "sleepy little agency" its then-chairwoman, Mary L. Schapiro, branded it in the 1990s. With power from Congress to oversee the previously unregulated $615 trillion market for over-the-counter derivatives, it has become one of the hottest lobbying spots in town. Companies want to "make sure the rules are right," says Malyshev.

The fight over how to increase transparency and reduce the risk of derivatives nearly derailed the financial overhaul bill. Derivatives are instruments that companies use to hedge risks, including fluctuations in interest rates and commodity prices; they are also used for speculation. It took a contentious all-night session of lawmakers to reach an agreement. Even then, Congress left many specifics to the CFTC and the Securities and Exchange Commission, with the first drafts of many rules to be published by yearend.

Since President Barack Obama signed the law on July 21, calling its passage a triumph over "the furious lobbying of an array of powerful special-interest groups," those same groups have turned to regulators to try to blunt

Weighing In at the CFTC
The website of the Commodity Futures Trading Commission lists more than 230 meetings and phone calls from July 26 to Oct. 8, most with corporate executives and financial services representatives.

8/11
4 P.M.
Topic: Which companies will face tighter scrutiny and capital rules

Blythe Masters
Jeremy Barnum
JPMorgan Chase

9/14
10 A.M.
Topic: Limits on the number of contracts one trader can hold

Eric Vincent
Nate Ebeling
Ospraie Management

Stephen Waldman
Tudor Investment

Joanne Medero
BlackRock Alternative Advisors *(ex-CFTC general counsel)*

John Tesoriero
Louis Dreyfus Highbridge

Greg Whalley
Centaurus Energy Management *(ex-Enron president)*

Jennifer Han
Managed Funds Association

Graham Harper
Delta Strategies Group *(ex-CFTC staff)*

9/14
2 P.M.
Topic: Which companies' trades will be exempt from clearing and margin rules

Scott Topping
Chris Monroe
Karen Judd Lewis
Southwest Airlines

James Newsome
Delta Strategies Group *(ex-CFTC commissioner)*

Scott Parsons
Delta Strategies Group *(ex-CFTC staff)*

Where Silicon Valley goes for answers page 44 ▶



the law's effect on their profits. Hedge funds have lobbied to be excluded from increased scrutiny and higher capital requirements. Airlines and manufacturers that use derivatives to hedge their commodity costs–and the dealers who arrange the hedges–want to be exempt from a rule requiring cash collateral for trades. Wall Street banks have sought to avoid caps on the number of derivatives they can hold in their accounts. "The number of people that have come in requesting to be exempt from the law or to have the law delayed has literally shocked me," says Bart Chilton, a Democrat who is one of the agency's five commissioners. "A lot of folks are having problems coming to grips with the fact that they do have a new law and will have to change their business models."

Chilton says he found himself confronting the same lobbyist representing three different companies in the space of two weeks. In each meeting, the attorney argued that his client was exempt from the law or that implementation ought to be put off, says Chilton. "The volume and intensity of the lobbying is unprecedented in my experience at the agency."

After the bill passed, CFTC Chairman Gary Gensler announced that the commission would post the names of anyone who came in to discuss the rules, which rankled. Malyshev, 44, who says the publicity can interfere with attorney-client privilege. "People are calling me asking, 'Hey, how did you get that client?' " says Malyshev, who according to the CFTC site also represents **Barclays** and **MarkitServ**, which processes derivatives trades.



Gensler posted the names of those who wanted to lobby his agency

The law gives the CFTC jurisdiction over commodities, interest rates, and some credit default swaps. According to the Office of the Comptroller of the Currency, U.S. commercial banks reported derivatives trading revenue of $6.6 billion in the second quarter, a gain of 28 percent from the same period a year earlier. Ⓑ

—*Asjylyn Loder and Phil Mattingly*

The bottom line *Congress gave regulators wide discretion to regulate derivatives, causing the CFTC to be besieged by lobbyists.*

Regulation

Brush Up Your Beltway-Speak

In Washington, you know you've arrived if you have an acronym. President Barack Obama has POTUS (President of the United States). The justices have SCOTUS (Supreme Court of the United States). With the expiration of the $700 billion Troubled Asset Relief Program, government-speak is losing some doozies–SIGTARP and FINSOB, anyone? Do not despair–the financial overhaul law that Congress passed and Obama signed in July has brought forth a whole new lexicon. Below, what's in and what's out. —*Robert Schmidt*

In

- **DFA** Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
- **CFPB** Consumer Financial Protection Bureau, *new agency to police consumer lending*
- **FSOC** Financial Stability Oversight Council, *new council of regulators to monitor systemic risk*
- **OFR** Office of Financial Research, *new Treasury Dept. office for collecting market data*
- **OMWI** Office of Minority and Women Inclusion, *new units financial agencies must create to promote diversity*
- **SEF** Swap Execution Facility, *a derivatives trading venue*
- **MSP** Major Swap Participant, *large users of derivatives that will get extra scrutiny*
- **FIO** Federal Insurance Office, *new Treasury Dept. unit monitoring insurers*
- **CFI** Complex Financial Institutions Office, *new Federal Deposit Insurance Corp. unit to liquidate troubled too-big-to-fail firms*
- **OCR** Office of Credit Ratings, *new Securities and Exchange Commission office to oversee credit-rating companies*

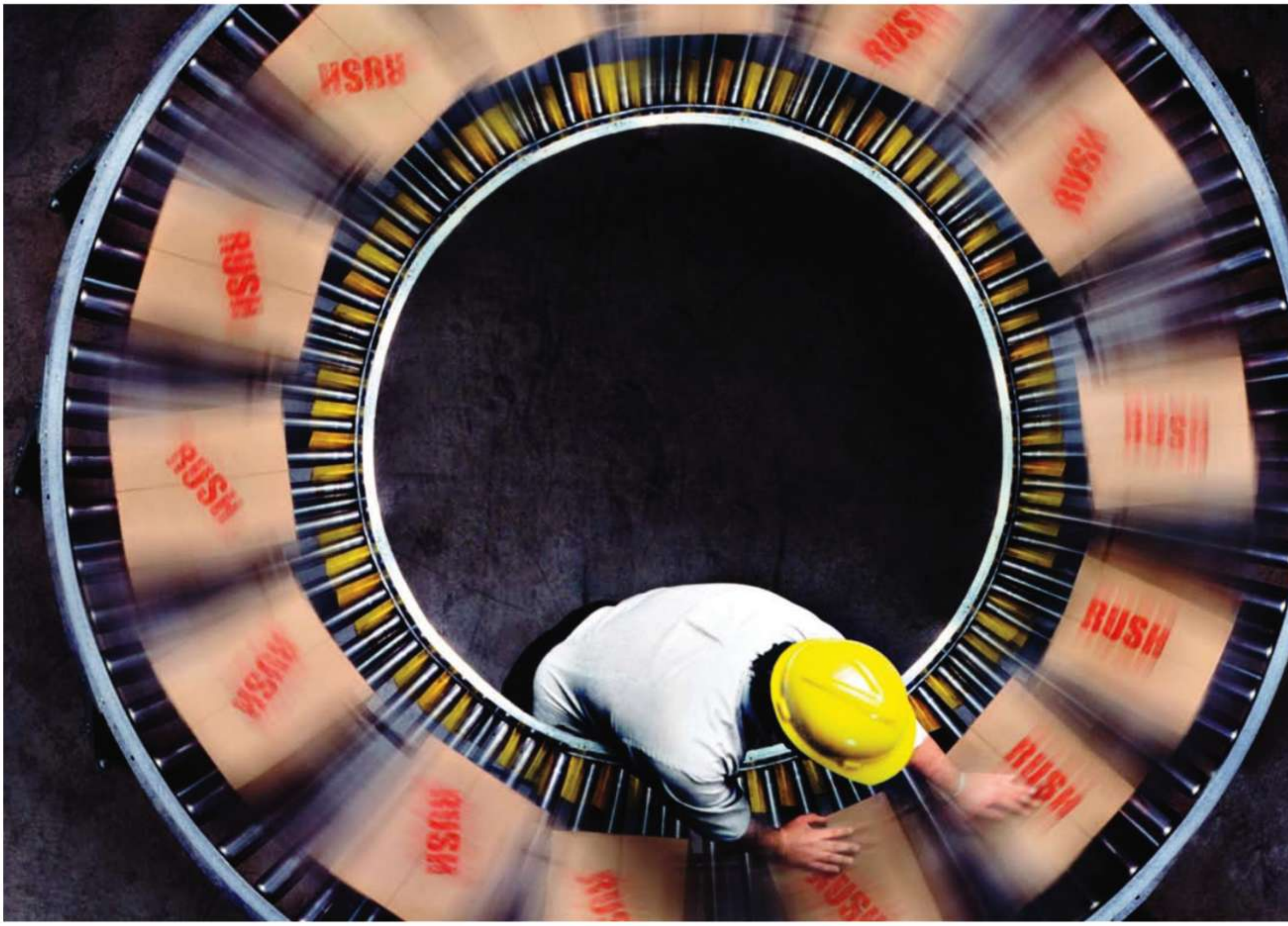
Out

- **EESA** Emergency Economic Stabilization Act, *the 2008 financial rescue law*
- **TARP** Troubled Asset Relief Program, *the $700 billion bank bailout within EESA*
- **PPIP** Public-Private Investment Program, *Treasury program to buy and sell troubled assets jointly with private financiers*
- **CPP** Capital Purchase Program, *cash infusions for banks*
- **TIP** Targeted Investment Program, *cash for extra-troubled firms such as Citigroup*
- **TLGP** Temporary Liquidity Guarantee Program, *FDIC guarantee of banks' debt*
- **TALF** Term Asset-Backed Securities Loan Facility, *Federal Reserve program subsidizing investor purchases of consumer and business loans*
- **HAMP** Home Affordable Modification Program, *Treasury program to help struggling homeowners*
- **SIGTARP** Special Inspector General for the Troubled Asset Relief Program, *an independent monitor overseeing TARP*
- **FINSOB** Financial Stability Oversight Board, *the panel of regulators monitoring the bailout*
- **COP** Congressional Oversight Panel, *another bailout monitor, this one reporting to Congress*
- **OTS** Office of Thrift Supervision, *the savings and loan regulatory agency that the new law eliminates*

LEFT: BRENDAN HOFFMAN/BLOOMBERG

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Technology



Allen and Gates with early PCs in 1981

1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993

1975
Bill Gates and **Paul Allen** set up shop to write programs for early PCs. Apple, founded a year later, pioneers the market for hardware while Microsoft sticks to software.



1980
Deal of the Century: Rather than buy Microsoft's DOS outright, IBM agrees to pay the software maker a cut on sales from its new PC line. PC sales grow; Microsoft gets a monopoly for the ages.

1985
First version of **Windows** goes on sale, and PCs gain share over Apple's new Mac, introduced the year before.



1989
Microsoft bundles various corporate programs to create a low-priced suite called **Office**—very bad news for rivals like Lotus and WordPerfect. Microsoft's second monopoly is born.

1992
Desktop PC sales explode thanks to huge improvements with Windows 3.1. A year later the company begins its assault on the lucrative server market formerly dominated by IBM, DEC, and others with Windows NT.

1995
Can business be any better than this? The company unveils Windows 95, with an assist from the **Rolling Stones** at the launch party.

1996
No tech company ever maintained dominance over successive computing eras. Maybe Microsoft is different. After dismissing the Internet as an unimportant fad, it reverses course. The **Internet Explorer** browser thrives.

Microsoft Needs Mobile To Be Its Next Killer App

▶ A hit with Windows Phone 7 would help keep the software giant at the center of computing

▶ "If Microsoft gets this right, the stock is really, really cheap"

In an interview shortly after unveiling **Microsoft**'s new Windows Phone 7 mobile software on Oct. 11, Chief Executive Officer Steve Ballmer declared a new era for Microsoft. "This is a big launch for us—a big, big launch," he boomed.

Ballmer, never known for understatement, may be lowballing this one. Gartner expects smartphone sales to surpass PCs in 2012. Microsoft remains immensely profitable thanks to its aging PC monopoly, and it will remain so even if it never figures out the smartphone market. Yet the stakes go beyond numbers—it's about staying at the center of computing while the world's information moves away from PCs and into the cloud.

People get e-mail, music, and Season Two of *Mad Men* on smartphones and other mobile devices—essentially pocket computers—and that information is warehoused at and delivered from far-off data centers, not PC hard drives. "If Microsoft gets this right, the stock is really, really cheap," says Michael F. Holland, founder of investment firm Holland & Co. "It would be an indication they've been able to evolve into a 21st century company."

By almost any measure, Microsoft is nearly out of the mobile game. Its market share fell to 5 percent from 22 percent in 2004, says Gartner. Customer satisfaction of Windows smartphones is 24 percent, according to ChangeWave Research; it's 74 percent for iPhones and 65 percent for handsets powered by **Google**'s Android. There are a few hundred apps for Windows mobile, vs. 250,000 for **Apple** and 70,000 for Android. Asked about Windows Phone 7's chances, Google Android chief Andy Rubin has said: "The world doesn't need another platform."

BLOOMBERG (3); CORBIS (1); AP PHOTO (2)

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2000
Steve Ballmer becomes CEO; a federal judge orders the company broken in two. Under threat from Linux, the company releases Windows 2000. New rival Google grows as Microsoft is caught napping.

2001
Xbox goes on sale. An appeals court reverses an earlier breakup order while upholding the finding that the company illegally protected its monopoly. The Justice Dept. and Microsoft settle the case.



2003
Microsoft rebrands its smartphones and Pocket PC PDAs as **Windows Mobile**.

2007
Windows Vista hits stores—with a thud.

Windows Phone 7, unveiled on Oct. 11



1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010

1998
Seemingly at the height of its power, Microsoft fights an antitrust suit from the U.S. Justice Dept. Efforts to conquer new markets such as online services (MSN), mobile software (Windows CE), and the living room (WebTV) fail to get traction.



2002
First mobile phone with Microsoft software goes on sale. Microsoft releases its operating system for tablet computers.

2008
Bill Gates steps down from his day-to-day role at the company, remains chairman.

2009
Windows 7 goes on sale.



2010
Microsoft's **Bing** reverses its slide in search. The company pulls its Kin smartphone after two months on the market. It also launches the total revamp of its mobile-phone software.

Unless, of course, Windows Phone 7 handsets, on sale Oct. 21 in Europe and Nov. 8 in the U.S., blow away consumers as the iPhone did back in 2007. Today, consumers load their smartphones with apps. Rather than tap between separate programs, Windows Phone 7 users will choose from a few larger icons—Microsoft calls them tiles—that aggregate information from related apps. For example, a "People" tile lets users contact friends via phone, text, or Facebook without having to click on any of those apps. An "Office" tile opens a screen to edit and send a PowerPoint deck or Word file, no attachments necessary. "This is the biggest step forward since Android," says Jonathan Sasse, senior marketing vice-president of Internet music company Slacker.

Microsoft mobile chief Andy Lees says Windows Phone 7 reflects his group's new approach to design. In the past, the company wrote the software and left it to licensees to ensure great products. This time, Microsoft set strict rules. All Windows Phone 7 handsets must come with three buttons (home, search, and back) and a camera with at least five megapixels of resolution. "In some cases that meant saying no to some of our largest partners," says Lees. He adds that Microsoft doesn't need to have as many apps as Apple or Android, just the most popular ones. That way Microsoft can assure the quality of Windows handsets. "Ours is a structured ecosystem," says Lees.

Building an ecosystem—there's the rub. The tech world usually jumps behind Microsoft's initiatives. That hasn't happened in mobile. With Apple and Google each activating more than 200,000 customers a day, according to those companies, handset makers, carriers, and app makers have far larger audiences than Microsoft offers. While **Dell**, **HTC**, **LG**, and **Samsung** make Windows Phone 7 devices, longtime Microsoft partners **Motorola** and **Hewlett-Packard** (by far the largest licensee of Microsoft's PC software) don't.

Although Microsoft wants to deemphasize apps, it still needs them. That's why it's paying some software makers to write apps for Windows Phone 7. While **eBay** and **Netflix** have obliged, many others won't until they see brisk Windows Phone 7 sales. Tim Westergren, founder of the popular online radio app **Pandora**, says he has no plans for a Windows Phone 7 app. "We'll go wherever we see the volume," he says.

Other factors could prevent Microsoft from having the debut many experts say it needs. Owners will not be able to "cut and paste" text or simultaneously run multiple apps as they can on most smartphones. While **AT&T** and **T-Mobile** will offer Windows Phone 7 devices, the software won't work with **Sprint** or **Verizon Wireless** until next year. (Apple's AT&T-only iPhone may be on Verizon by then.) Even AT&T, which co-hosted the launch event on Oct. 11, won't say how much it will invest to promote Windows devices. "It would be good to see carriers thinking they can differentiate themselves by heavily marketing Windows Phone 7," says Loomis Sayles analyst Tony Ursillo, noting Verizon's spending on Motorola's Droid phones.

Holding share in such a fast-

Technology

Why gold could keep climbing page 55 ▶



growing market could require sales of about 20 million units in 2011, no easy feat. That's how many iPhones Apple sold in its debut year. Ursillo estimates Apple will sell 75 million in 2012. Even if consumers were to somehow buy 37 million Windows handsets the same year, that would add just 3¢ per share in profit, says Ursillo. Sasa Zorovic, an analyst with Janney Montgomery Scott (who cut the stock to neutral from buy on Oct. 5), wants to see the company double market share by the end of next year.

Microsoft's to-do list doesn't end with Windows Phone 7. It has no tablet software that can match the iPad. Failing in smartphones would be bad. Failing in tablets, which users expect to run office software, would be catastrophic, says Elevation Partners co-founder Roger McNamee, who brings up once-proud computing names as worst-case scenarios. "If Microsoft misses the market for tablets," he says, "the collapse in their relevance to consumers will remind people of Digital Equipment and Wang 20 years ago."
—Peter Burrows and Dina Bass, with Cris Valerio

The bottom line *Microsoft's smartphone market share has fallen to 5 percent. It needs Windows Phone 7 to get it back into the game.*

5

BILLION DOLLARS

Projected cost of a U.S. offshore wind-power project. Google is buying a 37.5 percent stake in the first phase of the venture.

DATA: GOOGLE

Social Networks

Where Silicon Valley Goes for Answers



▶ Quora's Q&A site is an information trading post for tech insiders

▶ "An extraordinarily high level of engagement and passion"

Is **Quora** just one more entrant in the already overpopulated category of question-and-answer sites on the Web? That's a question you will find on Quora itself, which last spring joined **Yahoo! Answers**, **Formspring**, **Aardvark**, **ChaCha**, **WikiAnswers**, and many others in providing a forum where Web users ask and answer queries online.

Created by two former **Facebook** executives and funded by a third who became a venture capitalist, Quora has developed a loyal Silicon Valley following and a reputation as a hot, promising startup. The company has also morphed into something else: a bulletin board where Silicon Valley's most influential people routinely pack personal and professional insights into their answers.

On Quora, you'll find Dustin Moskovitz, a Facebook co-founder, discussing his feelings about the film *The Social Network* ("It is interesting to see my past rewritten in a way that emphasizes things that didn't matter"), and Werner Vogels, Amazon.com's chief technology officer, debunking notions about why the online retailer got into cloud computing ("The excess capacity story is a myth"). Netflix CEO Reed Hastings, Craigslist founder Craig Newmark, and Digg founder Kevin Rose, among other Valley luminaries, are all users. "I'm actually impressed at the information that users are willing to volunteer," says Lada Adamic, an associate professor at the University of Michigan who studies social and information networks. "There are things on there that I would consider insider information for some of these companies."

Co-founder Adam D'Angelo (left, in picture) roomed with Mark Zuckerberg at Phillips Exeter Academy and was Facebook's chief technical officer. He and Charlie Cheever (right), another Facebook colleague, left in 2008 to start Quora. Their mission: create a repository of knowledge that picks up where Wikipedia leaves off, and a site that can field the kind of detailed queries that Google gags on. "We want to get to the point where whatever question you have, you type it in, and there's already a great page of answers for you to look at," says D'Angelo, 26.

The company has designed its site to reward serious discussion and cut down on the repetition that characterizes other Web Q&A services. Duplicate questions on Quora are combined. Users, whose professions are listed after their names, can revise other people's questions and vote answers up or down. They also can create discussion summaries that everyone else is invited to edit. "We want an answer page to present the best versions of all the different arguments that are important, with the most relevant and important answers at the top," says Cheever, 29.

Cheever won't say how many users Quora has. According to researcher Compete.com, the site gets 150,000 visits a month, though its reputation in the Valley has grown faster than its traffic. More than 1,500 people RSVPd for a Quora community party last month, the company says, and invitees overpacked a San Francisco restaurant. Tech blogs religiously follow Quora's growth. Matt Cohler, a former Facebook executive and partner at Benchmark Capital, which led a $11 million investment in Quora in March, compares the site's appeal in the tech community to the early days of LinkedIn. "There's an extraordinarily high level of engagement and passion users have with the site," he says.

The company itself is lean. Fourteen employees huddle around a lone, long rectangular table in an office over a downtown Palo Alto (Calif.) arts supply store. D'Angelo and Cheever, who tend to work late into the night,

GOLD: VIENNASLIDE/ALAMY

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Technology

appear sleepy and shy in person. They declined to be photographed (they supplied the photo above), saying they prefer to keep the focus on the company.

They'll need more than humility to push Quora beyond the insular borders of the self-involved tech world. The site is free and anyone can join. The interface can be daunting, though. With its voting buttons, nested comments, and links to related questions, Quora isn't as simple to use as other Q&A sites like Yahoo Answers and **Answers.com**. Quora's biggest challenge may be its founders' former employer. Over the summer, Facebook launched a competing service, Facebook Questions. The Quora guys won't talk about that. Will Facebook get in the way of Quora's quest? That's another question on Quora, of course, with two well-reasoned answers by Valley residents taking different positions. No one has written that consensus summary yet. *—Brad Stone*

The bottom line *Q&A website Quora, a hit among techies, is trying to create a knowledge database that picks up where Google and Wikipedia leave off.*

Quoted



"Windows 7 is better than Vista. Mind you, there is s--- on my shoe that is better than Vista."
—Stephen Fry, author/actor/comedian, at a Microsoft event in London

Music

Pandora's Next Frontier: Your Wheels



▶ The leader in Web radio is stepping up its efforts to reach commuters

▶ "A big radio player needs to have a solution for the car"

Ask any teenager the coolest place to listen to music online, and you'll likely be told Pandora. The service has 65 million registered users who tune in for customized streams of, say, artists similar to Lady Gaga or a selection of rockabilly or rap, interrupted by just a handful of ads per hour. Until now, though, Pandora has had trouble reaching people in their cars, where most Americans do the bulk of their radio listening.

So **Pandora Media**, based in Oakland, Calif., is working with auto and electronics manufacturers to make it easier for users to get the online music service while driving. And Pandora has started approaching advertisers that buy time on broadcast radio, pitching the service's ability to reach targeted groups of consumers on their daily commutes. "Any company that wants to be a big radio player needs to have a solution for the car," Pandora founder Tim Westergren (pictured) told Bloomberg Television on Oct. 12. "We're just beginning that now."

By early next year, **Ford Motor** will be shipping Fiesta compacts with software that operates Pandora via voice controls. Later in 2011, drivers of several other Ford models will be able to skip a song on Pandora with a voice command or choose a new stream by simply saying an artist's name. **Mercedes-Benz** is offering Pandora controls on the steering wheels of some of its models, and **Pioneer Electronics** has started selling car stereos that can operate Pandora. Anyone wanting to listen to the service behind the wheel, though, still needs a smartphone or other device with a mobile Internet connection.

Pandora says it can help marketers reach listeners based on age, gender, ZIP Code, and musical taste, letting them deliver more relevant ads than what's possible on regular radio. That's because Pandora users provide such details when they register for the service. "It's very intimate," says Scott Kelly, digital marketing manager at Ford, which also advertises on Pandora and has hired

FROM TOP: PETER MARINER/UPPA/ZUMA PRESS; THOR SWIFT/THE NEW YORK TIMES/REDUX

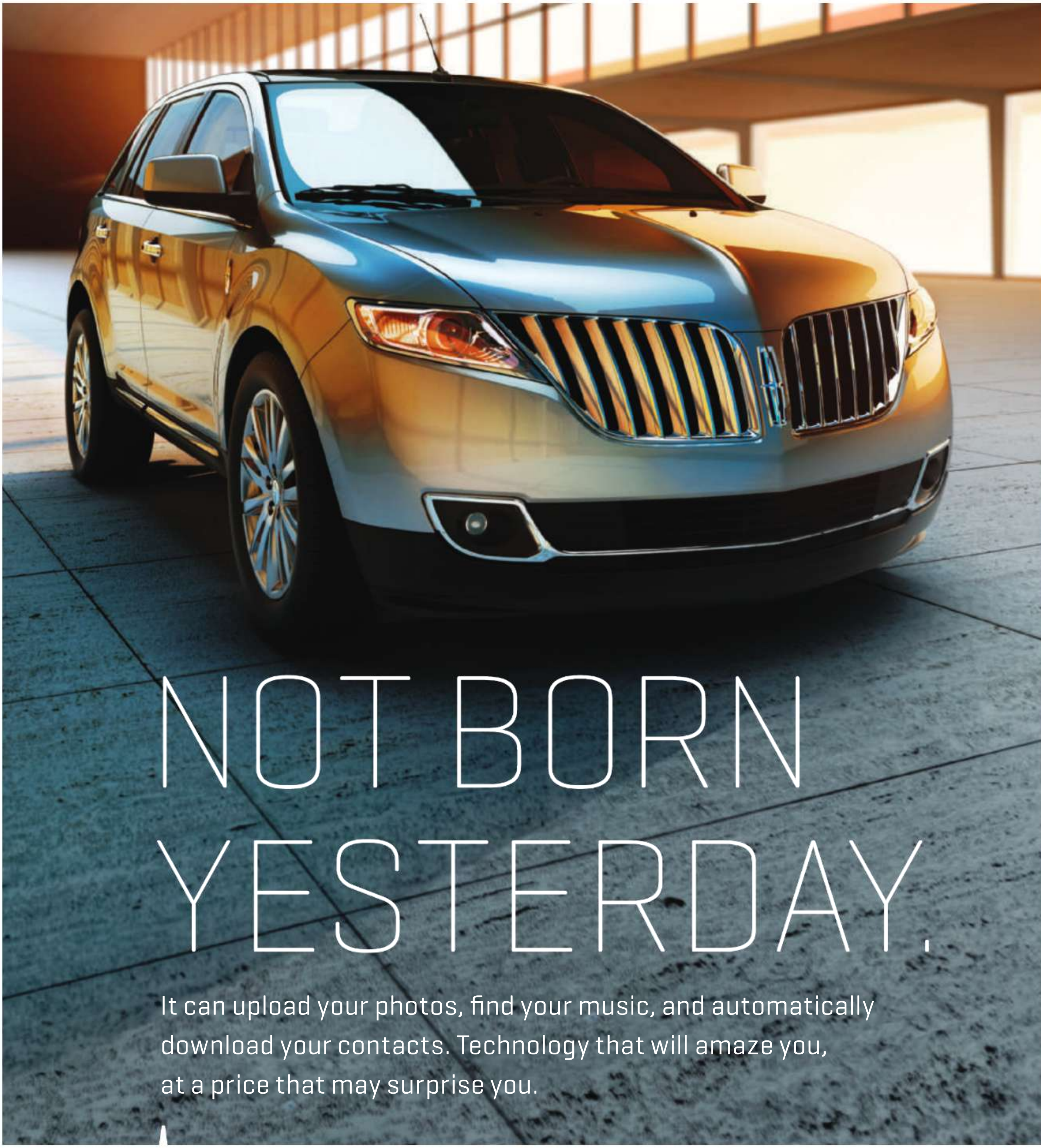
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singers John Legend and Jewel to promote the service. "It really lets us hone in on the message."

Founded in 2000, the privately held company burned through cash for much of the last decade and was almost forced out of business by rising music royalty fees. Its popularity on smartphones—Pandora is one of the top apps for both **Apple**'s iPhone and handsets running **Google**'s Android—helped the company turn a profit for the first time in the fourth quarter of last year. Revenue more than doubled in 2009, to $50 million, and could hit $125 million this year, predicts Internet analyst Steven Carpenter, who published an extensive report about Pandora in June on technology news website TechCrunch.

The company still has challenges. Pandora has little money for marketing because it pays between 60 percent and 70 percent of its revenue to artists. Ad sales for Internet radio are still dwarfed by traditional broadcasting; online services will get just 3.3 percent of the $17 billion in U.S. radio ad spending this year, according to researcher SNL Kagan. And Pandora faces growing competition from the likes of **CBS**'s Last.fm and startups such as Spotify, Mog, and Rdio.

3.3%

Online share of the $17 billion U.S. radio ad market in 2010

With more than half the Internet radio market, though, Pandora is attracting big brands. **Hallmark** and for-profit education company **DeVry Educational Development** have campaigns on Pandora. Grocer **Whole Foods Market** ran an audio ad in the San Francisco area, aimed at women aged 24 to 34, accompanied by an on-screen ad for a lunch special. **MillerCoors** uses Pandora to target listeners it knows are at least 21 years old, says Kim Luegers, who manages a campaign for the brewer at Chicago ad agency **Draftfcb**. "There are huge opportunities" for Pandora, says David Sze, a venture capitalist who led a $35 million investment in Pandora last year. "And auto is definitely one of those." —*Ari Levy*

The bottom line *After building a strong lead in Web radio, Pandora is hoping to get more listeners to tune in while driving.*

Innovator

Suranga Chandratillake



PHOTOGRAPH BY GABRIELA HASBUN FOR BLOOMBERG BUSINESSWEEK

A holiday encounter with a turkey led a data-mining professional to invent a search engine that trolls the Internet for videos

Talking turkey changed Suranga Chandratillake's life. For years he reluctantly dragged himself to family gatherings, knowing that every time someone asked him about his job, as an executive who sifted through corporate data for other companies, their eyes would glaze over. As it turned out, it was Thanksgiving that led him to a more interesting line of work.

Six years ago a chat with a co-worker turned to carving the holiday bird, and Chandratillake went online for tips. He found plenty of written instructions on the Web but not the video carving lessons he was seeking. Inspiration struck, and he decided to create a video search engine to help solve the problem. Blinkx was born.

Founded in 2004, the San Francisco company was a spin-off of Chandratillake's former employer, business software firm Autonomy. Blinkx sifts through the 35 million-plus videos on the Web to unearth anything from a clip of *Seinfeld*'s Soup Nazi episode to news footage of President Obama speaking on welfare reform. Most search engines rely on tags—the brief and often cryptic descriptions people write when they upload a video to the Internet. Blinkx searches for visual and audio cues as well as written descriptions to deliver results. "It's a bit like reading the book, not just the cover," says Chandratillake, 32, who was born in Sri Lanka and raised in the U.K. When he was 8, his father refused to buy him a video game until he showed some programming skills. He was hooked—dashing his parents' hopes he'd become a doctor.

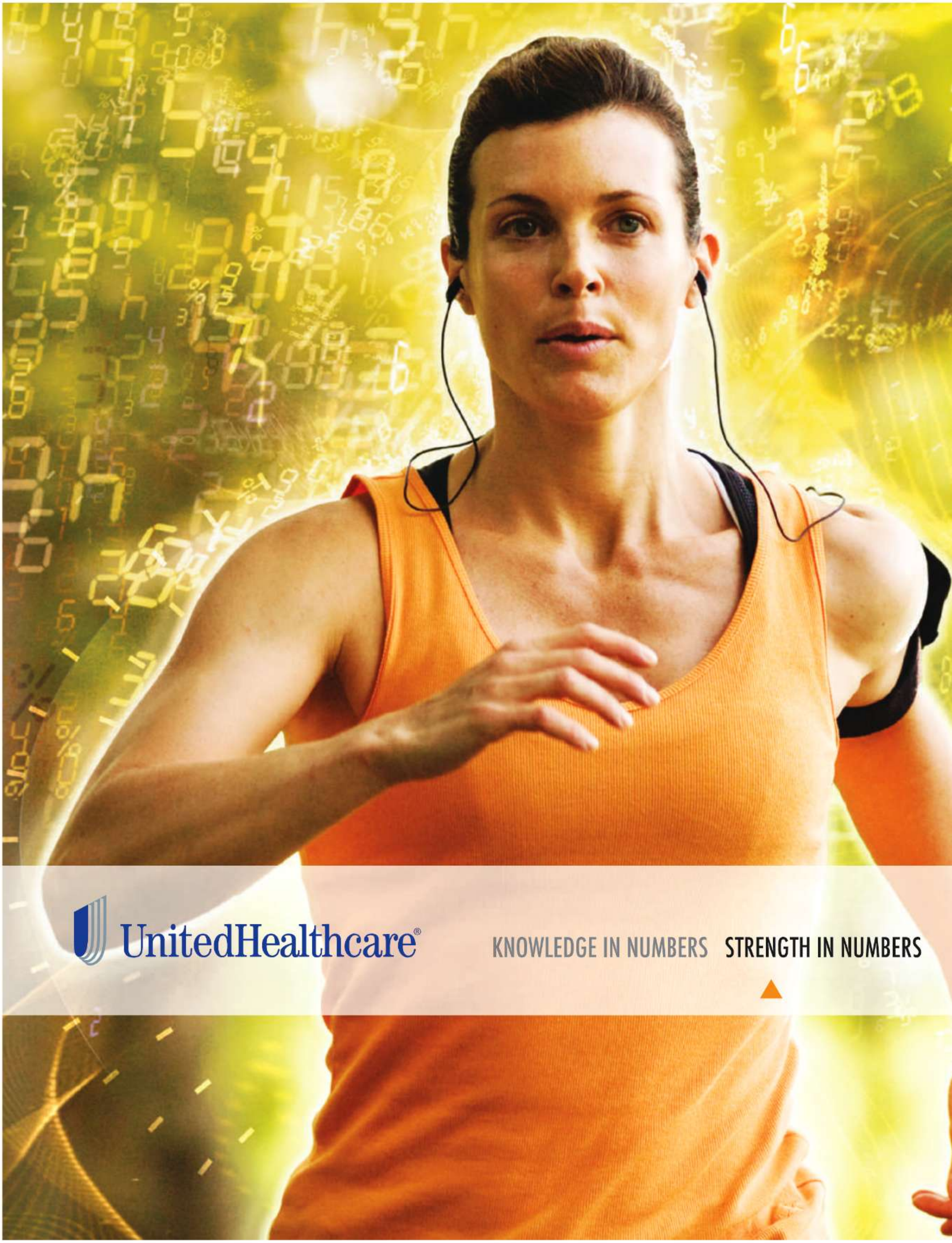
Blinkx, which went public in May 2007 on London's AIM market, has struck deals to power searches for video for Ask.com, MSN. com, and Samsung's Galaxy S smartphones. This fall, those who buy the Logitech Revue, a set-top box that allows users to browse the Web from a TV, will get access to Blinkx with an application that finds and delivers daily news and entertainment videos. Advertisers pay Blinkx to serve up marketing that's contextually relevant to videos consumers are viewing. Blinkx's early lead on video search could help it claim a big chunk of a Web ad market that researcher eMarketer expects to reach $96.8 billion by 2014. "Blinkx's efficient video search will become a prerequisite" for Web advertisers, says Daniel Stewart & Co. analyst Mike Jeremy. Blinkx logged its first operating profit this year.

With competitors such as Clicker trying to create their own video searching services, Chandratillake is pushing to get Blinkx on more smartphones, televisions, and other products. In late September, he announced a partnership with mobile startup Evri to find and deliver short videos of gossip and sports to Apple's iPhone, iPod touch, and iPad, as well as mobile devices using Google's Android operating system. "Video can just tell a better story sometimes," he says. Ⓑ —*Cliff Edwards*

Career ▶ **Went from corporate data mining to search**

Achievement ▶ **Turning first operating profit this year**

Potential ▶ **A slice of what by 2014 will be a $96.8 billion market**



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A foreclosure in Fort Myers: The state is struggling with a case backlog

Florida's Fast Foreclosure Machine Seizes Up

▶ **Some "rocket docket" hearings are canceled amid investigations of flawed filings**

▶ **"This entire system is now a great big question mark"**

At the George E. Edgecomb Courthouse in Tampa, Judge Sandra Taylor presides over one of the special courts set up to help work through Florida's backlog of foreclosure cases. Sitting at a desk in a fifth-floor conference room, with a court assistant and a cart stacked with manila envelopes at her side, Taylor uses a speakerphone to talk to attorneys for the banks and mortgage servicers who call in rather than appear in person. Most borrowers don't show up to contest the loss of their homes.

One day in early October, Taylor had 51 cases on her docket. It took her about 30 seconds to approve some of the actions and set a sale date after lenders' attorneys summarized the case and the amount owed. "I wish there was more we can do," Taylor told one homeowner who did appear. She said there was "no legal reason" why she shouldn't approve the foreclosure on the home.

Another homeowner, Ingrid Young, 44, told Taylor she couldn't afford the $1,900 monthly payment for her Tampa house because she earns only $1,800 a month. "I am in default, and I do realize that," she said. Taylor approved the foreclosure after persuading attorneys for CitiMortgage, a unit of **Citigroup**, to set the sale date in January, after the holidays. "It's a very sad business," the judge said during a break.

Florida has the third-highest foreclosure rate in the U.S. after Nevada and Arizona, according to RealtyTrac, the Irvine (Calif.)-based data firm. One in every 34 housing units—double the U.S. average—was in the foreclosure process or bank-owned as of Sept. 1. Florida's legislature appropriated $9.6 million this year to hire semi-retired judges and case managers to preside over foreclosure hearings such as those in Tampa, which have come to be known as "rocket dockets."

The goal is to clear 62 percent

BRUCE GILDEN/MAGNUM PHOTOS

War on computer worms page 65 ▶



of the backlog by next July, according to Craig Waters, a spokesman for the Florida Supreme Court. J. Thomas McGrady, chief judge of Florida's Sixth Judicial Circuit, once thought that was achievable. Now that **JPMorgan Chase**, **Ally Financial**, and other banks have put the brakes on foreclosures or evictions to look for any paperwork irregularities, McGrady is "very doubtful" his courts can do that. The Sixth Circuit, which covers the area around Clearwater and St. Petersburg, faces a backlog of 33,000 foreclosures, he says.

"All of a sudden all of these issues pop up with the lenders," McGrady says. "It's going to slow down the whole process. We're still getting 1,000 cases a month." At the Clearwater court, lenders as of Oct. 12 had canceled more than half of 84 hearings to approve foreclosures that were scheduled for the following day, according to Ron Stuart, a court spokesman. Half of 110 hearings set to take place the day after that had been canceled as well.

Among the alleged defects the banks are examining are lender affidavits signed by people, often described as "robo signers," who repeatedly failed to verify the accuracy of the information in the documents. A lawsuit filed last week by Ohio's attorney general accuses Ally and its GMAC Mortgage unit of committing fraud by submitting hundreds of false affidavits in foreclosure cases. Ally said in a statement that it "believes there was nothing fraudulent or deceitful about its foreclosure practices."

A coalition of all 50 state attorneys general, led by Iowa's Tom Miller, announced a joint investigation into foreclosures on Oct. 13. Florida Attorney General Bill McCollum has asked five lenders and mortgage servicers to meet with him to discuss ways to "redeem the integrity" of the foreclosure process. "Every homeowner that's in foreclosure now should be questioning" the documents, says Matthew Weidner, an attorney in St. Petersburg who defends homeowners in foreclosure cases. "This entire system is now a great big question mark." Oliver Chang, a housing strategist at Morgan Stanley, says that as many as 9 million U.S. mortgages in the foreclosure pipeline or already through the process may face legal challenges.

The lenders aren't the only ones coming under increased scrutiny. McCollum is investigating four law firms, including Shapiro & Fishman and the Law Offices of David Stern, that handle foreclosure cases on behalf of lenders. Among the banks represented by the firms the attorney general has targeted are CitiMortgage, **Bank of America**, and **Deutsche Bank**. McCollum accuses the firms of "unfair and deceptive actions" and says thousands of foreclosures that had been approved by judges may have been the result of their allegedly improper actions. Gerald Richman, an attorney for Shapiro & Fishman, says the firm is ready to cooperate with the attorney general's office if it narrows the scope of a subpoena seeking information, which Richman calls "invasive." Representatives of the other firms didn't return phone calls seeking comment. Citigroup says it has stopped steering foreclosure work to the Law Offices of David J. Stern.

Meanwhile, the foreclosure process grinds on. Weidner criticizes judges for continuing to hold rocket docket sessions amid the controversy over flawed documents. "Inside these courtrooms, judges—the bad ones—are just granting summary judgments like nothing's happening, like it's business as usual," he says. "They're abdicating their responsibilities to be real judges."

Several Florida judges say their job is not to advocate for homeowners or investigate the accuracy of documents—courts depend on homeowners or their attorneys to raise objections. "We're processing thousands of cases where no one is really contesting them," says W. Douglas Baird, a judge in Clearwater. "It's not a situation where the courts have the ability to go through every document that's filed and challenge and question those documents."

McGrady, the chief judge in Florida's Sixth Circuit, says his courts have seen "numerous situations of some very sloppy practice" by lenders. "I'm disappointed that perhaps they've taken advantage of a system that was set up to allow them to obtain their foreclosures in a reasonably fair and expeditious process," he says, "and they may have abused that." —*David McLaughlin*

The bottom line *As more questions arise about the legitimacy of foreclosure proceedings, Florida is having a hard time clearing its case backlog.*

4.07

TRILLION DOLLARS

The amount of U.S. government debt in foreign hands as of July. China held the most, $846.7 billion, followed by Japan, with $821 billion.

DATA: TREASURY DEPT.

Investing

A Quest for Yield Drives Up Phone Stocks

▶ **High payouts trump weak prospects for earnings growth**

▶ **"The value of dividends has been highlighted by the environment"**

Willing to give up the prospect of faster earnings growth for the current income offered by dividends, investors are driving the biggest rally for telephone stocks in seven years. **Verizon Communications** and Hong Kong-based **PCCW** have led a 21 percent gain in MSCI's gauge of 52 global telecommunications companies since the end of the second quarter, even as analysts estimate that the group's earnings will grow at less than half the pace of the MSCI World Index of stocks in 24 developed nations, data compiled by Bloomberg show.

Dividend yields of phone companies from **Royal KPN** to **AT&T** pay more than their own bonds, leading some money managers to favor equities over fixed-income securities. "I know they don't have earnings growth, but I am not buying them for growth but

FROM LEFT: JOE MAGEE; SPENCER HEYFRON

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Precious Metals

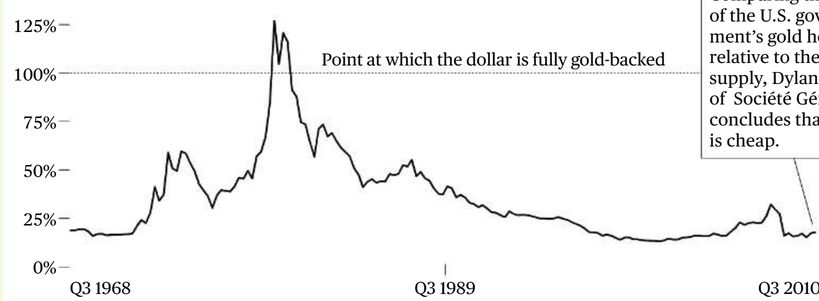
An Analyst's Case for Why Gold Could Keep Climbing

In November 2009, when gold traded for about $1,100 an ounce, money manager Barry Ritholtz wrote that his "intermediate target" price for the metal was $1,350 an ounce. Gold reached that level on Oct. 7 and hit $1,368 an ounce on Oct. 13. So where does Ritholtz, chief executive officer of FusionIQ, see it going? He considers three ways of valuing gold, shown below. "All three of the metrics suggest [gold] has not yet reached its highest potential price," Ritholtz says. "Slapping a $2,000 target is not unreasonable, and breaching its inflation-adjusted target of $2,358 is also possible." He adds an important caution: "Gold fever has risen to the point of excess," and gold shouldn't account for more than 5 percent of your portfolio.

A caveat from Ritholtz:
"I see way too many investors who have drunk the Kool-Aid. Gold feels like a crowded trade setting up for at least a minor correction."

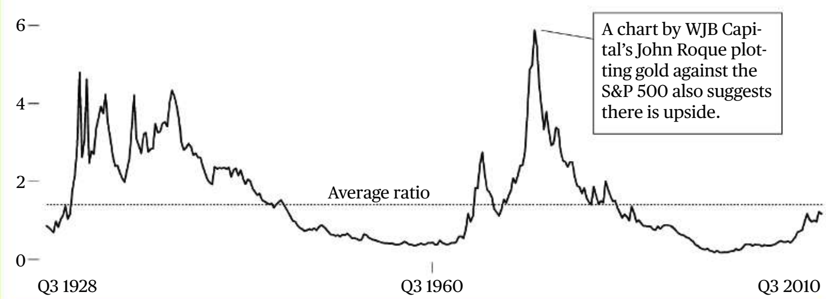


Value of U.S. gold holdings as a percentage of the money supply



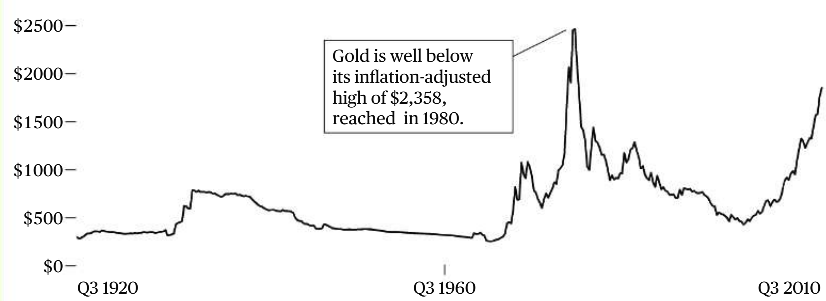
Comparing the value of the U.S. government's gold holdings relative to the money supply, Dylan Grice of Société Générale concludes that gold is cheap.

Ratio of gold price to the S&P 500 Index



A chart by WJB Capital's John Roque plotting gold against the S&P 500 also suggests there is upside.

Inflation-adjusted gold price, current dollars



Gold is well below its inflation-adjusted high of $2,358, reached in 1980.

DATA: SOCIETE GENERALE, WJB CAPITAL

for their very high, abnormal dividend," says Jacob De Tusch-Lec, a fund manager at Artemis Investment Management in London, which oversees $16 billion.

"The value of dividends has been highlighted by the environment, and first and foremost is just the low yields on competing assets," says Dan Hanson, a portfolio manager at New York-based **BlackRock**, which oversees $3.2 trillion. The average yield on investment-grade U.S. corporate debt hit a record low of 3.57 percent recently, according to data compiled by Bank of America. Sixty-nine companies in the Standard & Poor's 500-stock index paid a dividend yield above the average interest rate on corporate debt as of Oct. 8, the highest number in at least 15 years, data compiled by Bloomberg and Bank of America show. Telephone companies, long known for generous yields, account for 5 of the 10 largest payouts in the S&P 500 and yield 5.4 percent on average.

In the aftermath of the financial crisis, tech stocks have eclipsed financial stocks as dividend payers. Stocks in the information technology group accounted for 9.2 percent of the $210 billion in dividends paid out as of Oct. 11, compared with 8.9 percent for financial stocks, according to data compiled by S&P. In 2007, before the recession, financial stocks contributed 30 percent of dividends and info tech 5.7 percent. The average yield for tech stocks that pay dividends is 1.85 percent, compared with 1.37 percent for financial stocks.

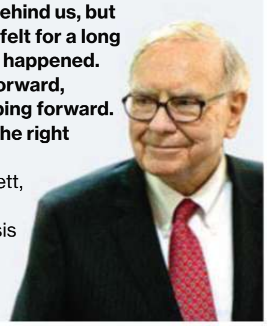
Investors are snapping up dividend stocks despite the uncertainty over taxes: Reductions in levies on capital gains and dividends enacted in 2003 will expire on Dec. 31 unless Congress extends them. Even so, investors put more money into the S&P 500's dividend exchange-traded fund, the SPDR S&P Dividend, last month than ever before, while the Dow Jones industrial average's dividend ETF, the iShares DJ Select Dividend Index, had its best month since January 2005, IndexUniverse.com data show.

Is the focus on dividends shortsighted? U.S. phone stocks trade at an average 16.5 times earnings as of Oct. 11, the highest valuation of any S&P industry group. Telephone companies are the only group that analysts project will post a drop in third-quarter and full-year earnings. Profits fell 8.1 percent in the July-to-September period and will decrease 4.2 percent for all of 2010, according to the average estimates in Bloomberg surveys. Earnings for the entire S&P 500 climbed 23 percent last quarter and will grow 35 percent this year. "For an extra 1 percentage point of dividend yield, they may be sacrificing 2 percentage points of growth potential," says Bruce McCain, who oversees $25 billion as chief investment strategist at the private banking unit of KeyCorp in Cleveland. "It's just an emotional reaction that they feel more comfortable with the higher yield."

—Lynn Thomasson, Whitney Kisling, Alexis Leondis, and Margaret Collins

The bottom line *With interest rates low and stock prices stagnating, investors are drawn to high-yielding equities—and phone stocks are benefiting.*

Quoted



"The worst is behind us, but the pain will be felt for a long time from what happened. We're inching forward, we're not galloping forward. We're going in the right direction."
—Warren Buffett, speaking about the financial crisis



Exports

Ireland's Unemployed Head Back to the Farm

▶ **Dublin hopes a food sector revival will ease a 13.8 percent jobless rate**

▶ **"Farmers have become a respected profession again"**

At **Bank of America**, David Farrell spent his days taking calls from credit-card customers in Ireland. Then came the global financial crisis, and the 40-year-old father of five decided it was time for a career change. In 2008, after five years with the bank, he quit and enrolled at Teagasc, which runs a school at Dublin's National Botanic Gardens college, to study horticulture. It turned out to be a shrewd move: Today the Irish economy is reeling, jobs are scarce in financial services, and one of the few sectors that shows any promise is agriculture. "There's a resurgence in producing food," says Farrell. "It will become something people not only want to do but may have to do."

Plenty of other Irish workers are thinking along the same lines. Farrell's college program in Dublin turned away 250 students seeking places in its agriculture-related courses last month.

FROM LEFT: STEFAN CHOW/BLOOMBERG; KINDRA CLINEFF/INDEX STOCK/CORBIS

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Farmland prices outside the Dublin area fell 43 percent last year

Enrollment for courses at Teagasc climbed to 1,128 this year, 45 percent more than in 2007, before the economy collapsed. The government agency teaches students such skills as growing organic food at sites across Ireland and supports the country's agribusiness sector.

Promoting food exports is a major priority for Irish Prime Minister Brian Cowen's government. Ireland's gross domestic product doubled in size in the decade through 2007 and has since shrunk about 15 percent after the real estate bubble burst. The government, struggling with bailing out banks and slashing public spending, is counting on food exporters, including **Kerry Group** and **Glanbia**, to help spark an economic revival. "Farming and agrifood were totally lost during the boom. It just wasn't seen as sexy compared with property and financial services," says Jim Power, chief economist at Friends First, a Dublin financial-services firm. "That's changing: High-value export industries like food are the future for us now."

After falling 12 percent in 2009, Irish food and animal exports are up 5.4 percent during the first half of 2010, according to Ireland's Central Statistics Office. About 150,000 people work in farming, still the country's biggest indigenous industry after 20 years of decline. Agriculture now accounts for about 2 percent of the Irish economy, compared with about 16 percent in the late 1970s.

Global investors have warmed up to Irish food stocks. The share price of Kerry Group, Ireland's largest food company, has risen 47 percent in the past two years. Dairy food company Glanbia has seen its stock price increase 13 percent over the same period. Unemployment has more than doubled to 13.8 percent since the peak of the "Celtic Tiger" years in 2007 and has reached 18 percent in the country's rural southeast, according to the latest government numbers.

During the boom years, construction, which accounted for about a quarter of the economy in 2006, drew agricultural workers off the land, says John Bryan, president of the Irish Farmers' Assn., Ireland's largest farmers' lobby. (Bryan is a beef farmer who oversees 230 acres in Kilkenny in southeast Ireland.) No more. "This year is the first I'd say in about 14 or 15 years that you'd have people calling to the farm to see if there is any seasonal work going," says Paul Kehoe, 34, who farms about 380 acres in Country Wexford with about 120 cows and 200 sheep.

Another factor working in agriculture's favor is the decline in land prices. Developers pushed up prices to more than €58,400 ($81,140) a hectare in 2006, the highest in Europe, according to the National Institute for Regional and Spatial Analysis, citing data from property agent Savills. Last year, farmland prices around Dublin fell 57 percent, while the average price paid in the rest of the country declined 43 percent.

5.4%

Increase in Irish food and animal exports during the first half of 2010

Ireland's tough economic circumstances have changed perceptions about the country's agricultural sector. "Farmers have become a respected profession again," says Power, the economist. "And there's nothing else out there."
—Louisa Fahy and Finbarr Flynn

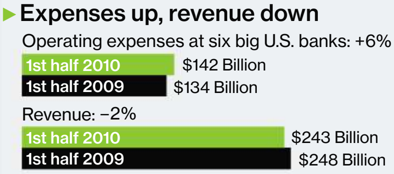
The bottom line *The government is counting on food exports to revive the economy and help lower Ireland's double-digit unemployment rate.*

Financial Services

The Big Squeeze On Bank Profits

▶ **Investments in new businesses have yet to pay off**

▶ **Expenses up, revenue down**



DATA: COMPANY REPORTS

U.S. banks are expanding into new areas to compensate for shrinking loan businesses, caps on credit-card charges and overdraft fees, and a ban on trades with their own money. **Citigroup**, for one, plans to hire 7,500 people in China over the next three years, double the number of private bankers in North America to almost 260, and recruit 100 commodities traders. At many banks, expenses are rising faster than revenue, eroding profit margins. "Investors would not be big fans of banks bringing down near-term returns on the promise that they'll grow revenue in the future," says Thomas Brown, chief executive officer of hedge fund Second Curve Capital in New York, which oversees about $250 million in bank stocks. "They'd rather see revenue growth out of the existing franchise."

First-half operating expenses at the six biggest U.S. financial companies by assets–**Bank of America**, Citigroup, **Goldman Sachs**, **JPMorgan Chase**, **Morgan Stanley**, and **Wells Fargo**–grew by $7.92 billion, or 5.9 percent, over the same period last year. Revenue fell by $5.6 billion, or 2.2 percent. Morgan Stanley was the only one at which first-half revenue growth outpaced costs. The hit from rising operating costs may become clearer as the banks announce third-quarter results. JPMorgan Chase, based in New York, reported that net income rose 23 percent as loan loss provisions fell. Expenses climbed 7 percent from a year earlier, while revenue dropped 11 percent. The bank said it's on track to hire 10,000 employees this year. The rest of the top six banks report starting Oct. 18. The average estimate of analysts

surveyed by Bloomberg is that profits will total $11.8 billion for the six. That would be a 20 percent increase from a year earlier, mainly because of lower loan-loss provisions, which banks count separately from operating expenses. It would be a drop of 27 percent from the second quarter. The KBW Bank Index, which tracks 24 of the industry's largest stocks, is up 13.3 percent this year through Oct. 12, compared with 6.6 percent for the Standard & Poor's 500-stock index.

Citigroup CEO Vikram Pandit, 53, has slashed costs by cutting jobs and shedding businesses, including the Smith Barney brokerage, the Primerica life insurance unit, and the Nikko Cordial securities unit in Japan. Pandit and his team have reduced assets by 22 percent in the Citi Holdings division, created last year to hold businesses tagged for exit. In the meantime, he has ramped up spending in the Citicorp division, which includes businesses he calls core to the company's stated mission of being "America's global bank." They include securities trading, investment banking, branch banking, credit cards, and corporate cash management.

First-half operating costs at Citigroup fell 1.3 percent from a year earlier to $23.4 billion, while revenue dropped 13 percent, mostly from the wind-down of Citi Holdings. Costs in the Citicorp division rose 14 percent, as revenue declined 3.6 percent. "We continue to focus on managing expenses, which includes investing in our core franchise," says Shannon Bell, a spokeswoman for the bank.

$7.92 BILLION

Increase in operating expenses for the six biggest banks in the first half

Citigroup's new spending should be monitored closely given the company's track record of ill-timed investments and inadequate risk management, says Mike Mayo, an analyst at Credit Agricole Securities USA in New York. "The burden is on Citigroup to show that it can invest for sustainable growth," he says. B —*Bradley Keoun*

The bottom line *Needing to replace lost revenue, banks are investing in new businesses, which may cut industry profits in the short term.*

Bid & Ask

by Cristina Lindblad



1 **Petronas Chemicals**, the petrochemicals unit of Malaysia's state oil company, hopes to raise as much as $4 billion in what would be the Southeast Asian nation's biggest initial public offering.

2 **Pfizer** is paying $3.6 billion for Bristol (Tenn.)-based King Pharmaceuticals to expand its roster of pain relief products.

3 **Koor Industries** reached an understanding with China National Chemical to take Makhteshim Agan Industries private in a deal valued at $1.9 billion. Israel's Makhteshim Agan is the world's No. 1 maker of nonpatented agrochemicals.

4 Children's apparel retailer **Gymboree** agreed to be acquired by Bain Capital for $1.8 billion.

5 **New Jersey** plans to issue $1.4 billion in bonds to replenish the state's infrastructure account. Governor Chris Christie's administration has suspended 100 projects because of a lack of cash.

6 Canada's **Talisman Energy** is paying $1.3 billion for a patch of the Eagle Ford Shale in Texas, an area rich in natural gas liquids, such as propane and butane.

7 **Electrolux** offered $433.8 million for Olympic Group for Financial Investments, a maker of household appliances that has a 30 percent share of the fast-growing Egyptian market.

8 **DeNA**, a Japanese social media website operator, is paying $303 million for Ngmoco, a U.S. developer of iPhone apps, including the popular We Farm and We Rule games.

9 **Energizer Holdings** is buying American Safety Razor, a maker of private-label razors and blades, for $301 million.

10 A Chinese art collector's $32.6 million winning bid for an imperial vase helped push **Sotheby's** total for its week-long Hong Kong sale of wine, jewelry, watches, modern art, and antiquities to a record $398 million.

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▶ How Stuxnet worms its way into factories 65 ▶ Speed Dial: Counterterrorism expert Richard Clarke 65 ● Edited by Barrett Sheridan

Smartphone Apps Go (Truly) Viral

▶ **The devices are becoming bigger targets for malware creators**

▶ **"The next great security company will be in the mobile space"**

In early 2009, **Citigroup** launched a new mobile banking application for the iPhone. It let customers check their account balances and pay bills while on the go. Thanks to a bit of sloppy code, it also could have let hackers access the banking information for 118,000 customers who downloaded the app.

This story has a happy ending–Citi discovered the security flaw in June, before hackers could exploit it, and the bank says no customer lost money. However, experts say hackers may be quicker to exploit shoddy coding the next time around. "The bad guys follow the money," says Charlie Miller, principal analyst at Independent Security Evaluators, a consultancy based in Baltimore. "Criminals are going to start focusing on phones."

The number of attacks is still low. Although security experts discover hundreds of new strains of malicious code targeted at PCs every day, they've detected only 67 directed at smartphones in all of 2010, says Sean Sullivan, security adviser for the North American labs of **F-Secure**, a Finnish security software developer. Still, that's nearly double last year's total, and mobile devices become a larger target all the time. Morgan Stanley analyst Mary Meeker predicts that smartphones will outsell laptops and netbooks this year and will eclipse sales of all PCs, including desktops, by 2012.

That means more potential victims of malware–as in malicious software–and more customers for the security companies that protect against it. Jeff Wilson, a principal analyst at consultancy Infonetics Research, expects global revenues from smartphone security software to rise from $219 million last year to nearly $1.4 billion by 2013. Securing a foothold in the growing mobile security market was a key motivation behind chipmaker **Intel**'s $7.7 billion purchase of **McAfee** in August and **Juniper Networks**' $70 million acquisi- ➔

ILLUSTRATIONS BY JOE MAGEE



Cyber Security

tion of **SMobile Systems** one month prior.

Much of the security companies' attention will likely be focused on **Google**'s Android software. It's the fastest-growing mobile operating system, and may also be the most vulnerable to hackers, says David Goldschlag, vice-president for mobile at McAfee. Unlike **Apple**, which vets applications before allowing users to download them to their iPhones, Google doesn't check the apps posted to its Android Market, says Miller. (Google didn't return repeated requests for comment.)

That makes it easier for hackers to create applications that surreptitiously spy on users or access phone functions without permission. In July, a Chinese security company, **NetQin**, found an Android app that posed as a restaurant tip calculator but also forwarded users' text messages to hackers. Such text messages can contain sensitive financial information, especially as more smartphone users engage in mobile banking.

Other hackers have built apps that automatically call expensive, premium-rate phone numbers, racking up big bills for users. SMobile Systems, which develops antivirus software for phones, estimates that 2 percent of the apps in Android Market are able to send text messages without a user's knowledge, while 5 percent can dial a number without permission.

Despite such statistics, many consumers don't consider security software as essential on a phone as it is on a PC. They're willing to pay for other security-related services, including data backup or software to locate a lost phone, but the market for such convenience products is becoming highly competitive. To differentiate their offerings, the security companies bundle their antivirus software with those popular features. In July, McAfee purchased a startup, **tenCube**, which runs a service that helps locate missing phones using the device's GPS. On Oct. 5, **Symantec** updated its antivirus software for iPhone and Android with tools to remotely erase data on lost handsets. SMobile Systems also includes data-wiping controls with its antivirus software.

Lookout, a startup in San Francisco, has compiled a database of more than 1 million smartphone apps. It uses that information to detect new threats and block potentially malicious applications. The company's apps also include data backup and the ability to remotely wipe data, and are used by more than 2 million people. John Hering, the chief executive officer of Lookout, which raised $11 million in venture capital in May, says the established companies like Symantec and McAfee don't yet have a lock on the field. "The next great security company will be built in the mobile space," he says. —*Olga Kharif*

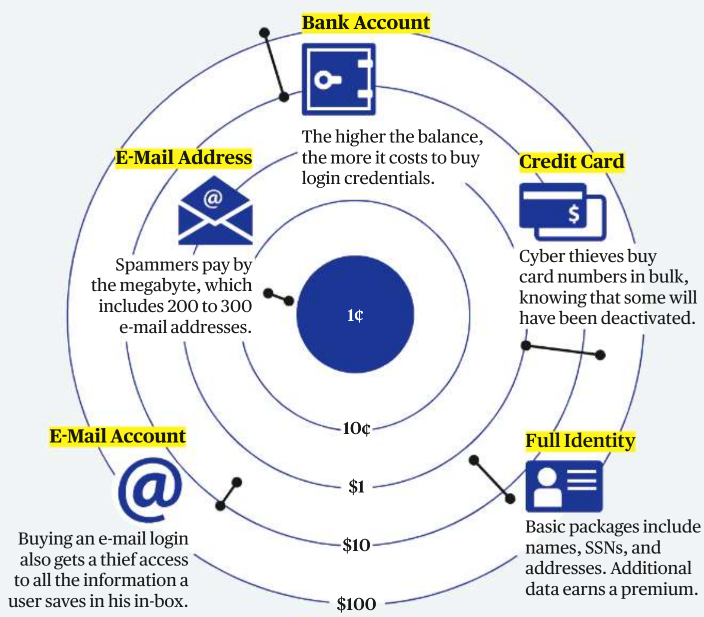


The bottom line *Protecting smartphones against malware promises to become a big business for makers of antivirus software.*

Data Theft

What Your Identity Goes for Online

You don't have to be a hacker to steal a credit card number. On underground Web marketplaces, thieves routinely buy and sell personal data–including bank log-in information. And the advertised prices are surprising. —*Barrett Sheridan*



DATA: *SYMANTEC INTELLIGENCE QUARTERLY*

ICONS BY MATT OWENS

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Contracting

Safeguarding F-15s, And Your Credit Card

▶ Government contractors look at securing commercial networks

▶ They're "uniquely positioned to solve" thorny cyber problems



Northrop's Tim McKnight says networks are the U.S.'s "weak underbelly"

Unless they're buying low-priced sneakers, battle tank designers don't interact much with discount retailers. Still, when cyber thieves stole millions of customer records in 2007 from **TJX**, the operator of Marshalls and T.J. Maxx, the company called in experts from **General Dynamics**. Based in Falls Church, Va., the defense contractor is better known as the maker of the military's Abrams battle tanks. "Within hours, our forensic experts were able to identify how the breach occurred and we were able to fix the problem," says Nadia D. Short, vice-president for strategic planning at General Dynamics.

Such unconventional partnerships are on the rise. Corporations are building more complex networks to record and analyze the data from their businesses. Infrastructure is being outfitted with digital sensors to better monitor and control utility services. Those technologies will bring new efficiencies–and new cyber security risks, as critical data and infrastructure become vulnerable to attacks or theft by hackers. Networks are the "weak underbelly of the U.S.," says Timothy McKnight, **Northrop Grumman**'s vice-president for information security and a former FBI agent specializing in computer fraud.

Defense contractors are "uniquely positioned to solve" cyber security problems for utility companies, power grid operators, credit card processors, and others that run complex networks, says Steven Grundman, vice-president for aerospace and defense at the consulting firm Charles River Associates in Boston. Such networks are actually made up of many smaller, connected networks, and only defense companies have experience protecting so-called "systems of systems," he says. A typical IT consultancy, he adds, focuses on one company and one computer network at a time. The missile-defense program, however, required building and protecting missile interceptors, ground-, sea-, and space-based radar, and control equipment. That experience helped **Boeing** and **Lockheed Martin** win grants last year to work with utility companies to develop prototype smart-grid systems with military-grade cyber security. The grants are part of a $4.5 billion program run by the Energy Dept.

Barbara Fast, a former U.S. Army major general and now head of Boeing's cyber security operations, says her company is at an advantage because it already works "in both commercial and government sectors, unlike any other major competitors." The cyber defenses Boeing uses to protect the fighter jets it builds for the government may be applicable to commercial planes as well, especially as the latter are increasingly "digital and need security safeguards in place," she says.

Government agencies will remain the biggest purchaser of cyber defense services. John Slye, an analyst at market researcher Input, estimates the government will spend $11.7 billion on cyber defense contracting by 2014, up 48 percent from $7.9 billion in 2009. That growth is attractive to defense contractors, especially when their traditional business of weapons development is growing no faster than the rate of inflation.

To compete for government dollars, they're hiring experts and building facilities to monitor computer networks. Northrop Grumman and Lockheed Martin both have opened cyber security centers in the last two years. **Raytheon** has hired 1,600 cyber experts and will open its own lab in 2011. Such expertise puts them at a "decisive advantage" over traditional security companies, says Grundman. —*Gopal Ratnam*

The bottom line *Defense contractors are leveraging their government experience to provide cyber defenses for commercial networks.*

PHOTOGRAPH BY ANDREW CUTRARO FOR BLOOMBERG BUSINESSWEEK. OPPOSITE PAGE, FROM TOP: ETHAN MILLER/GETTY IMAGES; SCOTT J. FERRELL/CONGRESSIONAL QUARTERLY/GETTY IMAGES

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Does the Tea Party know business? page 66 ▶



Industrial Systems

How Hackers Worm Their Way Into Factories

▶ Default passwords can't be changed on some computers

▶ The Stuxnet worm has "master keys to get inside this kind of system"

At a September conference in Vancouver, Liam O Murchu, a researcher with the computer security firm **Symantec**, used a simple air pump connected to an industrial computer to pop a balloon. The computer's program called for the pump to stop before the balloon burst. But O Murchu had loaded the Stuxnet worm onto the machine, which let him order the pump to keep going. That, he says, shows what can happen when bad guys gain control of industrial systems: "Imagination is the limit."

The spread of the Stuxnet computer worm has heightened fears about the security of industrial control computer systems that run factories and power plants. The rogue program, which affects machines sold by **Siemens**, has been found in computers around the world, Symantec says. Most are in Iran, leading analysts to believe that its nuclear program is the target.

O Murchu hypothesizes that the worm may have been unleashed via a USB drive that was plugged into a computer. In some instances, rogue programs have come from USB drives dropped in parking lots that were plugged in by a curious person. Once loaded, the worm can spread because passwords for many industrial control programs—required to give the machine instructions—are either hard to change or can't be changed at all, says Frank Heidt, chief executive officer of Leviathan Security Group, a consultancy in Seattle. "Whoever made Stuxnet gave it a set of master keys to get inside this kind of system," he says.



The weakness goes beyond Siemens, Heidt says, showing passwords in owner's manuals for industrial control software from **Honeywell**, **ABB,** and **Invensys**. Siemens says the company issued a fix for Stuxnet within a week after it learned of the worm in July and that few customers have had problems. Honeywell and ABB say they are addressing the password issue. Invensys says its security is sufficient.

The risks to such computers were illustrated three years ago when researchers at the Idaho National Laboratory tried to seize control of an electrical generator over the Internet. While the findings of Project Aurora, as it is called, are classified, a leaked video shows a generator emitting black smoke as it follows the team's rogue instructions.

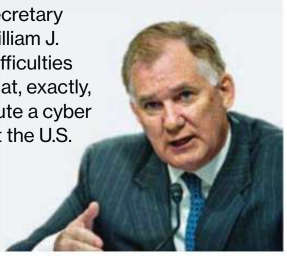
Many industrial control systems were designed before anyone dreamed of connecting them to the Internet. They run machines that have been in place for decades and remain in use longer than most computers. Over time, these systems were linked to the Internet to allow companies to monitor output, material consumption, and inventories. "It was a very natural progression," says Michael Assante, the former security chief of a U.S. utility industry group. "Someone would say 'We need to get the data that we can capture from the plant and get it into the financial system.' "

Security experts take some solace in Stuxnet's complexity, which means that few organizations could create such a worm. Symantec's O Murchu estimates that Stuxnet was written by a team of a dozen programmers working for at least six months, at a cost of more than $3 million. "With an attack like this," he says, "you have to know a great deal about the target in order to get the desired result." Ⓑ *—Arik Hesseldahl*

The bottom line *Stuxnet highlights the vulnerabiity of computers that control factories, many of which were developed before the Internet era.*

Quoted

"I mean, clearly, if you take down significant portions of our economy, we would probably consider that an attack."
—Deputy Secretary of Defense William J. Lynn on the difficulties of defining what, exactly, would constitute a cyber attack against the U.S.



Speed Dial Richard Clarke

The chief counterterrorism adviser to the Clinton and Bush Administrations says the U.S. isn't ready to defend itself against a significant attack on its digital infrastructure.

In your book *Cyber War*, you spell out what the U.S. needs to do to protect itself digitally. What are three priorities?
Job One would be to have the government work with Internet service providers—the half dozen companies that operate the big pipes through which all the data traffic comes into the country—and require them to be looking for specific attacks. I don't want the government to do the actual scanning because that raises privacy issues.

What's the second job?
Securing the power grid. Making sure that the networks and systems used to control it aren't connected to the Internet, where they can be attacked. Then you make sure there's a diversity in the operating systems being used, and, where possible, use proprietary operating systems.

Aren't power utilities already required to lock their systems down?
They are. The only problem is that the Federal Energy Regulatory Commission doesn't have the audit capability to find out if they're complying with the regulations.

And the third thing you'd do?
Start thinking about fundamentally rearchitecting the Internet. We're still using the basic architecture that Vint Cerf came up with 30 or 40 years ago. I'd start putting some R&D money into efforts to see if there are other ways of running the Internet than the system we developed back when we thought everyone using it would be honest.
Ⓑ *—Arik Hesseldahl*

The Devil You Don't Know



The Tea Party's small-government slogans may be appealing, but its policies could throw the U.S. economy into chaos.

By Lisa Lerer and John McCormick

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Beck, the Tea Party's chief theologian, at his August rally on the National Mall

Nikki Haley is almost everything the South Carolina Chamber of Commerce could want in a candidate for governor: A former small business owner (she helped run her family's luxury-clothing company in Lexington, S.C.), Haley has served on the boards of two local chambers and campaigns on the traditional business gospel of lower taxes and smaller government.

As Haley was steaming toward an easy win in the Republican primary runoff last June, the South Carolina Chamber's board—56 business leaders representing sectors ranging from banking to health care to construction—met at Clemson University to decide whether to endorse her or her general election opponent, Vincent Sheheen, a Democratic state senator. It took only 20 minutes around a U-shaped conference table for the board to make its decision: Almost 80 percent of members voted for the Democrat—even though they knew Haley was a virtual lock to become the next governor of their heavily Republican state.

The issue, as the board saw it, was Haley's extreme and inflexible approach, an ideology of confrontation that can be summed up in two words: Tea Party. Haley had allied herself with this grassroots network of self-described mad-as-hell revolutionaries, which has overrun the GOP—sending at least 14 Senate candidates, including challengers and incumbents allied with the movement, into the Nov. 2 elections—while accusing other Republicans of abandoning conservative tenets. Haley became one of Sarah Palin's "Mama Grizzlies"; the former Alaska governor and Tea Party celebrity endorsed her in May.

For business leaders who prize pragmatism and stability, it was all too much. "We worried about her ability to get along with the legislature," says Otis Rawl, chief executive officer of the South Carolina Chamber of Commerce. "We wanted to bring the debate away from the Tea Party and back to the middle." Chamber members, he says, tend to be "more realistic and moderate in their thought processes. We prefer candidates who are not extreme. If you look at the Tea Party, I think most of them would say they hate Big Business."

To businesspeople concerned about the 9 percent increase in federal spending under President Barack Obama and the Democratic-controlled House and Senate, a Tea Party-led return to fiscal austerity has undeniable appeal. That's certainly what the leaders of this anarchic, decentralized movement are selling. Tea Party principles, Palin told *Bloomberg Businessweek* in a brief interview on Sept. 11 in Wasilla, Alaska, are "exactly what we need for free enterprise and business in America because these are commonsense solutions. It's just getting back to the basics, realizing that growing government—and reaching into our private sector by government—is not the solution. That has been proven throughout eternity."

There's no such thing as the Tea Party platform; in the absence of centralized leadership, Tea Party-backed candidates have come up with an array of positions based on the doctrine of less intrusive government. Most say they would preserve the Bush tax cuts, end the estate tax, and lower taxes on savings and dividends. They'd repeal the federal health-care reform law, abolish the Federal Reserve, and shrink or shutter a range of other federal agencies. They are not numerous or popular enough to enact all of these positions; less than three weeks before the midterm elections, the *Cook Political Report* rates Tea Party candidates in three Senate races—Nevada, Colorado and Kentucky—as "toss-ups."

To measure the Tea Party's success by who wins on Nov. 2, however, is to miss the movement's full impact. Through a combination of brilliant politics, genuine discontent, and intense emotional appeals, the Tea Party has helped pull national Republican leaders such as John McCain to the right, and has defeated those—such as Lisa Murkowski in Alaska and Bob Bennett in Utah—who didn't move quickly enough. Its impact on the local level has been similarly dramatic. In May the historically moderate Maine Republican Party adopted a platform that included such Tea Party planks as eliminating the Federal Reserve, sealing the borders, and prohibiting stimulus funding.

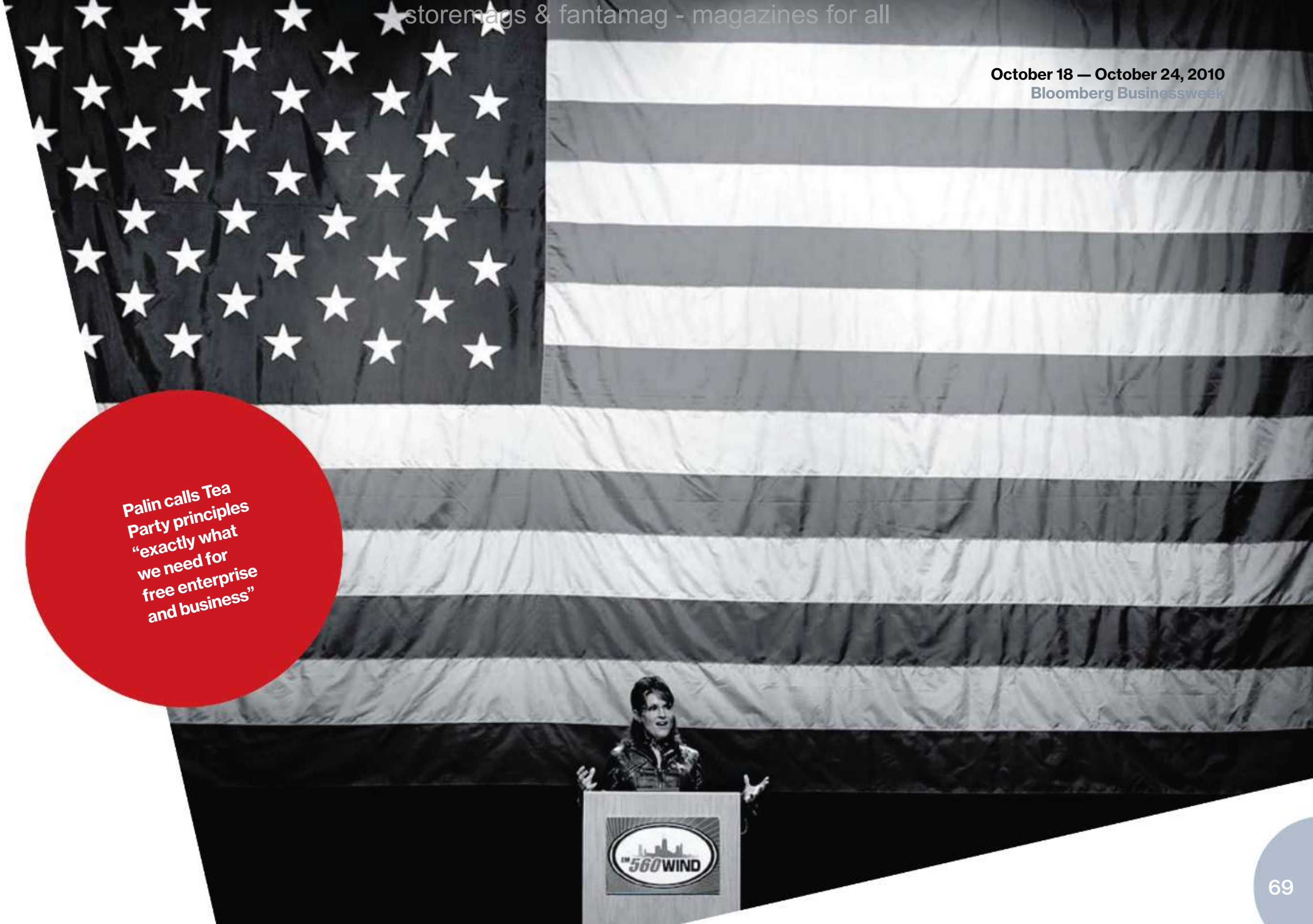
It may sound like a corporate dream come true—as long as the corporation in question doesn't have international operations, rely on immigrant labor, see the value of national monetary policy, or find itself in need of a subsidy to boost exports or an emergency loan from the Fed to survive the worst recession in seven decades. Business leaders who favor education reform, immigration reform, or investment in infrastructure can likely say goodbye to those ideas for the short term as well; they won't be possible in the willfully gridlocked world of the coming 112th Congress.

As the South Carolina Chamber realized, the Tea Party's seductive small-government principles are hitched to a train full of explosive cargo—from Alaska's U.S. Senate candidate, Joe Miller, who suggested Social Security is unconstitu-

"We want to bring the debate back to the middle," says South Carolina Chamber of Commerce CEO Otis Rawl. "If you look at the Tea Party, I think most of them would say they hate Big Business"

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Palin calls Tea Party principles "exactly what we need for free enterprise and business"

tional, to Delaware's U.S. Senate candidate, Christine O'Donnell, who has no relevant job experience. (She's a former sexual morality campaigner and perennial candidate who at times has had no visible means of support, and who once claimed to possess classified information that China was planning to take over the U.S.) The Tea Party's brand of political nitroglycerin, in short, is too unstable for businesses that look to government for predictability, moderation, and the creation of a stable economic environment. "A lot of the agenda is being driven by the extremes," says John Castellani, the former head of the Business Roundtable who left in July to take the helm of the Pharmaceutical Research and Manufacturers of America (PhRMA). "This kind of extremism makes it much harder to plan from a business perspective." (So far this election cycle, PhRMA's political action committee has sent about three-quarters of its campaign contributions to Democrats, according to the Center for Responsive Politics.)

Even the U.S. Chamber of Commerce, the biggest-spending business lobby and a vociferous opponent of the Obama Administration, has kept its distance from many Tea Party candidates. The Chamber, which has been the target of White House attacks over undisclosed campaign expenditures, says it plans to spend at least $75 million in this election cycle. So far, most of the money has gone to Republicans not closely associated with the Tea Party, such as former Hewlett-Packard Chief Executive Officer Carly Fiorina in California and former U.S. Trade Representative Rob Portman in Ohio. The Chamber has endorsed Rand Paul, the Tea Party-backed U.S. Senate candidate in Kentucky, and former Florida House Speaker Marco Rubio, an early Tea Party favorite who is running for the U.S. Senate in Florida and is distancing himself from his Tea Party roots. The Chamber evaluates each Tea Party candidate individually, says national political director Bill Miller, because "all of our friends have different characteristics." Miller expects that the Tea Party candidates who win will be forced to moderate some of their views. "Some of the politics of the Tea Party and legislative practicalities just don't match up.," he says.

Consider three prominent Tea Party politicians: Palin, Paul, and South Carolina Senator Jim DeMint, whose endorsements and campaign contributions have made him a kingmaker on the right. All say they support lower taxes, less regulation, and smaller government. Yet they have divergent and at times inconsistent ideas about how to achieve those goals. As governor of Alaska in 2007, Palin raised taxes on oil companies to increase revenues for her state. DeMint celebrates governmental gridlock, telling *Bloomberg Businessweek* his business supporters call it "the best thing that could happen for business." He says he wants to deport all illegal immigrants, and he opposed the $700 billion bailout of the financial system in 2008.

Paul is among those who want to abolish the Federal Reserve and the IRS. He would have let the U.S. automakers fail last year—a position with ramifications not only for car companies and parts makers but also for agriculture, mining, and other industries dependent on government support. Paul describes Medicare as an unsustainable boondoggle, though about half his income as a Kentucky ophthalmologist comes from Medicare and Medicaid payments, according to his campaign, which says that's in line with the national average for eye doctors. Last year, Paul advocated a $2,000 deductible for Medicare patients, which would shift more of the cost

PREVIOUS SPREAD: KRISTOFFER TRIPPLAAR/SIPA; JIM PRISCHING/AP PHOTO

burden to retirees, though he's retreated from that idea in recent days. Locked in a close race against state Attorney General Jack Conway, he has been sounding more like a conventional politician, focusing his rhetoric on Obama instead of the Tea Party. On Oct. 9 he thanked "the guy in the White House" for making "this election juggernaut possible."

Ask Bill Miller of the U.S. Chamber what his 98-year-old group likes best about the Tea Party, and his reply is blunt: its opposition to the White House agenda, particularly health care, climate change legislation, and phasing out tax cuts for the wealthy. "What they are for is important," he says, "but what they are against is almost more important."

That oppositional force—against Obama, against bailouts, against spending and regulation—attracted conservative political and business leaders to the Tea Party from the unlikely moment it came into being. Its date of birth is usually given as Feb. 19, 2009, a time when the Great Recession was still in its most frighteningly vertiginous phase. That morning, CNBC on-air editor Rick Santelli, who reports from the floor of the Chicago Mercantile Exchange, unleashed a rant heard 'round the world, asking why Americans should have to "subsidize the loser's mortgages" by propping up Fannie Mae and Freddie Mac. A few traders around him began cheering. "We're thinking about having a Chicago tea party in July," Santelli continued. "All you capitalists that want to show up at Lake Michigan, I'm going to start organizing."

It was enough to light the fuse. As local activists began using the Internet as an organizing tool, Fox News amplified the discontent on its airwaves, with on-air personalities Glenn Beck and Sean Hannity rushing to the front of the Tea Party parade, adopting the nascent movement as their own. Other journalistic organizations took notice during the summer of 2009, when House passage of the Waxman-Markey climate and energy bill and congressional debate over health-care reform unleashed more conservative anger and activists began disrupting town hall meetings held by members of Congress.

Business leaders began trying to direct the parade as well. A libertarian nonprofit called FreedomWorks, which grew out of Citizens for a Sound Economy, a group founded in 1984 by billionaires Charles and David Koch—the brothers who control Wichita-based petroleum conglomerate Koch Industries, the second-largest privately held company in the U.S., according to *Forbes*—had been holding annual antitax rallies throughout the 1990s with little to show for it. Now a true grassroots movement was spreading, and FreedomWorks wanted to channel it.

The nonprofit, chaired by former House Republican leader Dick Armey, began holding training sessions for Tea Party activists, and a FreedomWorks volunteer, Bob MacGuffie, reportedly circulated a memo with tips—"You need to rock-the-boat early in the Rep's presentation"—for those who wanted to disturb town halls. With Beck and others, the organization helped shape an emerging Tea Party cosmology in which Big Government and Big Business are twin poles of an evil empire plotting to destroy free enterprise and screw the little guy.

"Big Business is sitting there on fat, pushy duffs looking for government to



O'Donnell, the Tea Party's Senate candidate from Delaware, once said she "dabbled" in witchcraft

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"Big Business is sitting there on fat, pushy duffs," says FreedomWorks' Armey, "looking for government to keep them in business"

keep them in business," said Armey in an August interview with *Bloomberg Businessweek*. Only "incompetent" companies needed bailouts, he added. "People who run corporations are basically taking care of themselves. They're not very reliable people, and they're very comfortable with Big Government that greases the skids for them."

During his 18 years as a congressman from Texas, from 1985 to 2003, Armey accepted more than $900,000 in contributions from financial, insurance, and real estate companies, according to Federal Election Commission records, and almost $400,000 from energy and natural resources companies. After leaving office he joined DLA Piper, one of the largest law firms in the world, and became chairman of FreedomWorks. Armey says he left Piper last year after the rowdy demonstrations at town hall meetings brought unwanted media attention to the firm.

FreedomWorks says it plans to spend $10 million turning local Tea Party chapters into political machines. The group is steering funds into tools that help local groups organize, such as campaign flyers and signs, a phone system that lets volunteers across the country make calls for candidates from their computers, and an online mapping system to target likely voters.

Operating those tools are conservatives like Ryan Hecker, a Houston antitrust attorney who worked as a senior researcher for Rudy Giuliani's 2008 Presidential campaign. Hecker moved into grassroots organizing after the election. "I got involved in political and economic conservative causes because I wanted to be part of something greater than myself," he says. In September 2009, Hecker and other Tea Party activists organized an online effort that became the "Contract from America," a list of 10 Tea Party goals—slashing the size of government, repealing the health-care reform law, blocking a cap-and-trade system to reduce greenhouse gas emissions, and scrapping the IRS code and replacing it with a single-rate code no longer than 4,543 words, the length of the original U.S. Constitution. Over a period of several months in late 2009 and early 2010, he says, they gathered 1,000 ideas online and held a series of surveys and discussions to winnow the list to 21. About 500,000 Web votes were cast to arrive at the final 10 items.

Published in April 2010, the Contract from America creates what Armey calls a "seal of approval" for Tea Party candidates. There are obvious similarities between the Contract and the anti-regulatory wish list of libertarian David Koch, who is among the nation's 10 wealthiest Americans, according to *Forbes*, with a net worth of $21.5 billion. Yet Koch has distanced himself from the Tea Party in media statements, and a Koch Industries spokeswoman, Missy Cohlmia, says Koch's foundations don't fund FreedomWorks, though "we applaud anyone willing to advance economic freedom and opportunity in a civil and respectful manner." (The Koch brothers have supported an affiliated pro-Tea Party group, Americans for Prosperity.) "We live by the creed 'hard work beats daddy's money,'" Armey says. "We are not a corporately well-funded operation, as we are alleged to be." Hecker says FreedomWorks helped with publicity but didn't shape the Contract. "This is a grassroots document," he says. More than 300 candidates have signed it, including about 15 House incumbents. "We're looking for candidates who truly believe in the ideology," he says.

Confirmation of the Tea Party's power came in January 2010, when Republican Scott Brown won the Massachusetts Senate seat once held by the late Edward M. Kennedy. Rand Paul's May primary win in Kentucky, over a candidate backed by the state's Republican Establishment, added to the momentum, as did primary victories by Tea Party-backed Senate candidates Sharron Angle in Nevada, Ken Buck in Colorado, and Miller in Alaska.

The movement's energy could help boost Republican turnout, but it has also forced the party to spend time and money on primary contests in which inexperienced candidates—Angle, O'Donnell—have jeopardized Republican control of Congress. Despite her call to privatize Social Security, Angle is in a virtual tie with Senate Majority Leader Harry Reid and has raised an astonishing $14 million in the past three months. If Republicans fail to win the congressional majorities that seemed within reach earlier this year, she and other Tea Party candidates may take the blame.

To the movement's true believers, however, winning is less important than ideological purity. "We need people up here who understand that we've got to get back to limited government, and we cannot afford to have other Republicans who don't get that message," DeMint said recently on Capitol Hill. One cornerstone of their faith—the notion that large corporations are leeches sucking the blood of the people—is sharply at odds with Republican theology that has held sway for generations. "The business community writ large is the essence of the inside-the-Beltway type," says lobbyist Rich Gold, who represents Dow Chemical, NextEra Energy, and other energy companies. "And these people are the essence of the outside-the-Beltway type."

The Tea Party's chief theologian is Beck, the cable-TV personality whose rise has mirrored the movement's. Beck's world is full of demons, but the devil that enraged the sold-out crowd in a ballroom at the Atlantic City Hilton on Aug. 5 wasn't Obama or even House Speaker Nancy Pelosi. "Give the money to the people!" Beck shouted to a packed room of around 1,500. "Give us our money back—not to Goldman Sachs!"

In 2009 a campaign by the liberal group Color of Change confronted Beck's advertisers with clips of the TV host making racially charged statements

JESSICA KOURKOUNIS/THE NEW YORK TIMES/REDUX

Kentucky's Rand Paul wants to abolish everything from farm subsidies to the Federal Reserve



ED REINKE/AP PHOTO

on his show. In July 2009, for instance, he called Obama a "racist" with a "deep-seated hatred for white people or the white culture." According to the group, more than 100 companies joined a boycott of his show last year. Beck declined to be interviewed; Fox News has said it didn't lose revenue because advertisers shifted to other programs.

Tea Party activists describe Beck as the intellectual leader of their movement. They devour the books he mentions on his show, many of them the works of fringe political theorists such as W. Cleon Skousen, an anticommunist historian too extreme for conservative activists of the Goldwater era. In *The Five Thousand Year Leap,* published in 1981, Skousen argued that business, communists, and government were conspiring to push the U.S. into "a world-wide collectivist" society. After Beck authored a new foreword to the 30th anniversary edition, the book shot to the top of the Amazon.com best-seller list. "Beck is the great educator," says Representative Jason Chaffetz, a Utah Republican allied with the Tea Party. "He's empowering people with history and information."

The conspiratorial message was still fairly novel in 2009, when a group of corporate leaders led by General Electric CEO Jeffrey Immelt came out in support of the Waxman-Markey climate bill, which would cap industrial emissions that contribute to global warming. As Beck led the charge against the corporations, calling them Enron-style favor-seekers, Republican leaders in Congress found themselves attacking not only GE but also DuPont, Alcoa, Duke Energy, and other stalwarts of the U.S. economy. "Corporations should not be at the public trough," says DeMint. "We do not need corporations or their associations selling out just because they can get a little carve-out in some bill."

In June the Tea Party-affiliated National Center for Public Policy Research demanded Immelt's resignation, calling GE an "opportunistic parasite feeding on the expansion of government." Immelt's offenses included lobbying for a $450 million earmark to fund an F-35 Joint Strike Fighter engine, taking advantage of federal subsidies for clean energy, and running the conglomerate that owned liberal cable channel MSNBC.

Americans who support the Tea Party brim with contradiction. An October Bloomberg National Poll found that while 83 percent of Tea Party supporters favor repeal of the health-care reform bill, majorities would keep key provisions of it. Fifty-seven percent would prohibit insurance companies from denying coverage to patients with preexisting conditions, 52 percent would add more prescription drug benefits for Medicare users, and 53 percent would require states to set up plans for people with major health problems. "The ideas that find nearly universal agreement among Tea Party supporters are rather vague," says pollster J. Ann Selzer, who conducted the survey. "You would think any idea that involves more government action would be anathema, and that is just not the case."

Tea Party candidates show no such ambivalence. When it comes to government, they don't want to trim fat, they want to amputate limbs. Angle says she would eliminate the Environmental Protection Agency, the IRS, Fannie Mae, and Freddie Mac. Buck says he would get rid of the Energy and Education Depts. And candidates across the country say they aim to eliminate the web of special tax breaks, earmarks, and subsidies that benefit industries from golf cart manufacturers to the largest automakers.

In March 2008, Representative Michele Bachmann (R-Minn.), the leader of the newly formed 24-member Tea Party caucus in Congress, introduced legislation that would repeal the national phaseout of conventional lightbulbs in favor of compact fluorescent lights. Congress, she said, had no right to tell consumers what kind of bulbs to buy. Her bill was opposed by the electrical and manufacturing industries, which had already begun the transition.

Tea Party supporters want to seal the borders, depriving industries such as technology and agriculture of a major source of labor. They have turned a stringent Arizona immigration law passed in April into a cause célèbre for the movement. "We're all Arizonans now," says Palin. Buck, a former prosecutor who rose to prominence in Colorado after a series of high-profile immigration raids. Most famously, Buck's office raided a tax preparer and seized thousands

More than 80 percent of Tea Party supporters want to repeal the health-care reform law. Yet majorities say they would keep its key provisions

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The only good watt is a negawatt.

3 kWh generated | 2 kWh distributed | Only 1 kWh left for use



Due to intrinsic inefficiencies, 1 kWh consumed at the point of use requires 3 kWh of primary energy created at the power plant.

What's a negawatt? The one you didn't use.

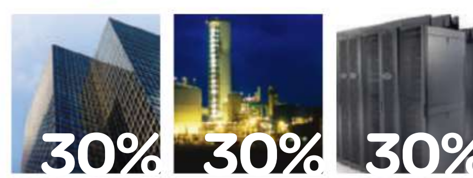
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*Source: World Energy Outlook 2009, IEA/OECD

of confidential documents. The search was later ruled unconstitutional by the Colorado Supreme Court.

Another Tea Party villain is the Federal Reserve. As Rand Paul travels around Kentucky, he blames the recession primarily on the central bank, which he says sent "bad signals" to the marketplace. His desire to abolish the Fed is shared by his father, libertarian Texas Representative Ron Paul, who spread banking conspiracy theories during his 2008 Presidential run. In the Senate, DeMint has also pushed for greater scrutiny of the central bank, holding up the renomination of Fed Chairman Ben Bernanke until Senate leadership agreed to a vote on his bill proposing regular congressional audits of the Fed.

On global trade issues, the Tea Party tilts toward protectionism. In polling earlier this year by the Mellman Group, a majority of Tea Party supporters said they would favor a tax on imports from countries with lower environmental standards. In June, Bachmann suggested that the U.S. should somehow withdraw from the global economy, calling the Group of 20 summit "one short step" away from "one world government."

"I don't want the U.S. to be in a global economy where our economic future is bound to that of Zimbabwe," she told a conservative radio host.

This set of policy prescriptions doesn't sit well with the regulars inside the clubhouse at Bowling Green (Ky.) Country Club. The wooded retreat is frequented by Rand Paul and other local business owners. Even Paul's supporters inside the modest clubhouse concede some uneasiness about their hometown candidate and his Tea Party compatriots. "If he were a mainstream Republican, this election would probably be over," says physician Bill Wade, a Republican, sitting in the clubhouse.

Paul is for the elimination of everything from farm subsidies to mine safety laws and has said private businesses should have the right to discriminate. Although Kentucky farmers, including his in-laws, collected $3 billion in farm subsidy payments from 1995 through 2009, he has questioned the wisdom of such payments. "There are a good number of Republicans that are uncomfortable with certain Paul positions," says Bill Betson, a county Republican chairman in the state.

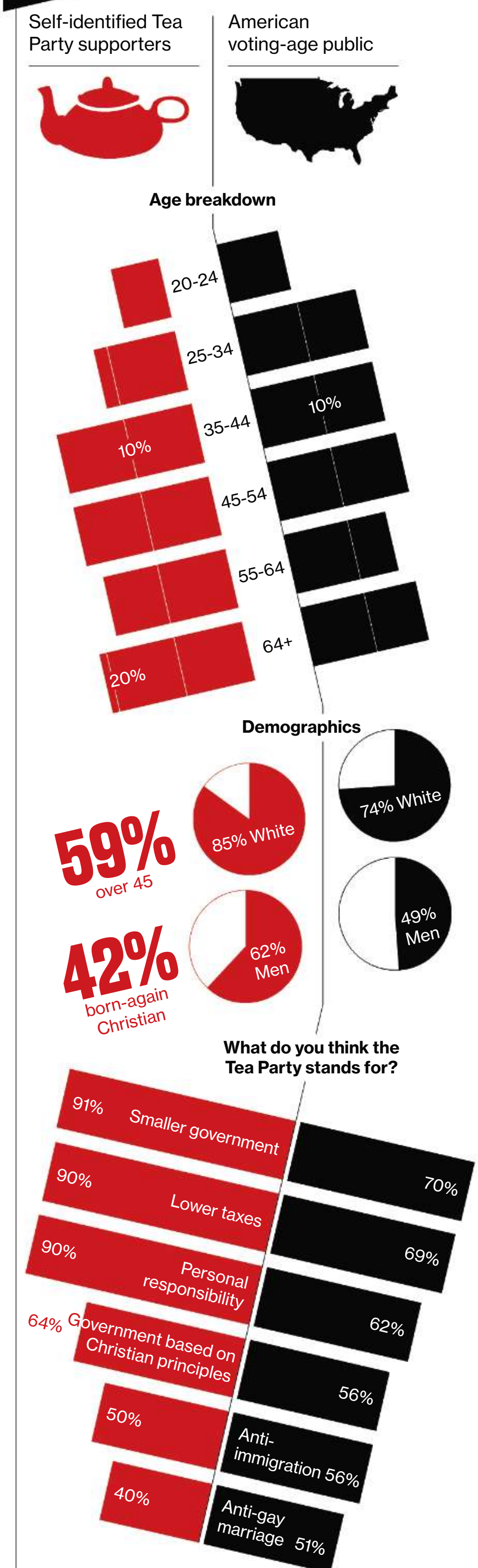
As he argues against government, Paul often cites his experience as a small business owner. "Without the profit incentive, without meeting a payroll, they don't make good decisions," he says. "Government can't do things as efficiently as the marketplace because they don't get the right signals." Asked whether business has anything to fear from the Tea Party or his own candidacy, Paul is emphatic. "No. I think business needs to be afraid of the vision of the Democrats who believe that government should be in charge of everything," he says during a brief interview at an event in London, Ky. "We believe in term limits, a balanced-budget amendment. Read the bills. Those sound like pretty calm, mainstream ideas."

A few minutes earlier, hammering away in his stump speech, Paul had trotted out Hitler to make a point about the dangers of economic uncertainty. "When you have chaos, bad things happen in your country," he began. "In 1923 there was chaos in Germany. Out of that chaos, they elected Hitler. And what did Hitler do? He vilified certain people and said, 'These people caused your problems.' He blamed it on these people and he said, 'Give me your liberty and I'll give you security.' There is still a danger to that."

Back in the clubhouse, another waiting golfer, a Republican building supply company owner named Ferrell Price, confesses to uncertainty about Paul's libertarian views. But, he adds, "Nancy Pelosi scares me a whole lot more than Rand Paul." Ⓑ

South Carolina Senator Jim DeMint has pushed for greater scrutiny of the Federal Reserve. Some Tea Party candidates want to abolish it

Bloomberg National Poll: Who are the Tea Partiers?



DATA: BLOOMBERG POLL OF 721 RESPONDENTS, INCLUDING 252 SELF-DESCRIBED TEA PARTY SUPPORTERS, CONDUCTED OCT. 7-10 BY SELZER & CO. (MARGIN OF ERROR: PLUS OR MINUS 3.7 PERCENT); U.S. CENSUS BUREAU

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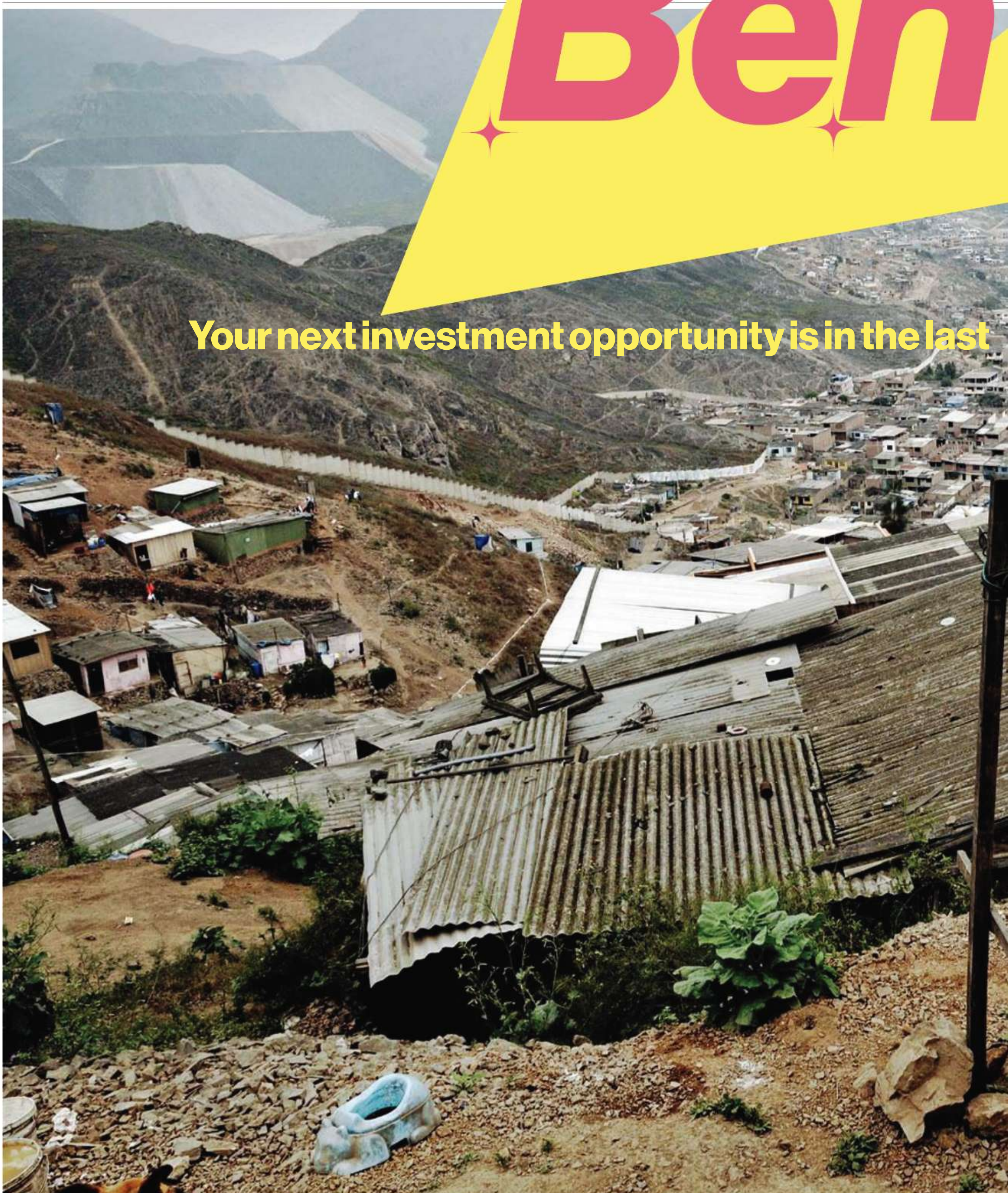
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place you'd think to look. *By Roben Farzad*

Lima, Peru: The stock market went from 23 to 23,000 in 16 years



The streets of Lima, Peru, are lined with slot machine parlors and stoplight vendors. Vans bulge with passengers as their drivers run red lights and the vehicles spew exhaust. Stray dogs, beggars, and nursing mothers mill about. But James Harmon only sees the cranes dotting the skyline.

Harmon is a frontier investor, and he's disposed to spot opportunities hiding amid chaos. Today he's touring a new pasta-making factory in a nondescript hangar tucked behind high walls and a double security gate. He's excited about the prospects for Alicorp, a $1.3 billion food manufacturer and a standout in Harmon's $200 million Caravel Fund, which is up 26 percent this year and 221 percent in the six years since it launched. "They're now churning out 10 times the noodles in half the time," Harmon, 74, yells over the roar of brand-new Italian machinery. He's wearing a hard hat with his suit, and errant bits of macaroni bounce off his freshly shined shoes.

In the span of two decades, Peru has graduated from near-failed-state status to a stable democracy with an investment-grade credit rating and some of the most consistent economic growth in the world. Its unlikely comeback is just one case study in the booming frontier, the extreme edge of emerging-market investing: Pakistan. Ghana. Egypt. Bahrain. Lebanon. Cypress. Kenya. In 2005, Goldman Sachs, having already coined the term "BRIC" to refer to Brazil, Russia, India, and China, introduced the "Next 11" (N-11), positing that Bangladesh, Egypt, Indonesia, Iran, Korea, Mexico, Nigeria, Pakistan, the Philippines, Turkey, and Vietnam were poised to rival the G-7 in economic influence in the 21st century. "The astute investor is now zeroing in on the next wave of developing nations—the late bloomers, the ones that have been flying under the radar screen," says Jerry Haar, an associate dean of the business school at Florida International University in Miami. The great equalizers, Haar says, are newfound macroeconomic stability, microeconomic reform, and consumer growth led by a rapidly expanding middle class—especially the lower middle class. It's a major reason why the International Monetary Fund expects emerging and frontier markets to grow at nearly three times the average rate of the developed world. "The bottom of the pyramid," says Haar, "is discovering banks, credit cards, and the many joys of capitalism."

Harmon realizes that most people don't see what he sees in Lima. And he's grateful that the majority of American investors react to enterprises like Alicorp with a mixture of apathy and arrogance. " 'So you figured out how to mass produce a low-margin staple,' " he says, mimicking a U.S. fund manager speaking up at a meeting for prospective investors. " 'Why should I care?' " It's precisely this perception gap that Harmon's fund lives to exploit.

In September, a group of Goldman Sachs strategists led by Timothy Moe predicted that the next 20 years will see the total equity capitalization of emerg-

ANGOLA

Population
13m

5-Year GDP Growth
63%

% Revenue from Oil
80%

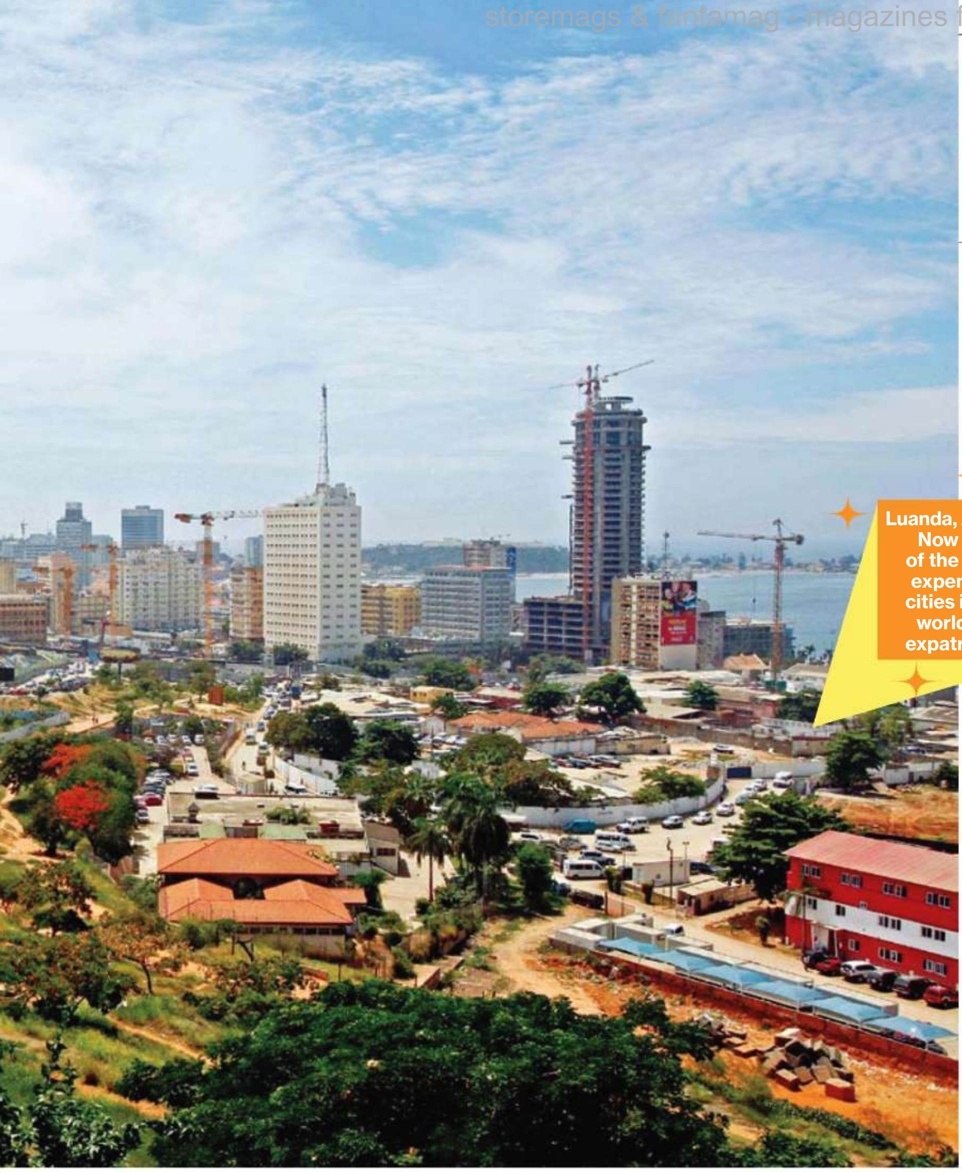


The former Portuguese colony endured a civil war from 1975 to 2002. It has since joined OPEC and become Africa's No. 3 oil producer.

DATA: BLOOMBERG; CIA FACTBOOK; IMF; WORLD BANK

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ing markets soar from $14 trillion today—about the same value as all listed American companies—to $80 trillion, a change that will prompt a land grab for assets across the developing world. Failed economies will become frontier ones before graduating to emerging markets status, while established emerging markets such as South Korea and Brazil come to be seen as fully developed. Wal-Mart just demonstrated its confidence in global economic maturity by offering $4.6 billion to buy Massmart, a South African retailer with supermarkets in Botswana, Uganda, Zambia, and eight other sub-Saharan countries. BlackRock, the world's largest asset manager, will soon be launching a frontier investment trust, while HSBC readies an exchange-traded fund that focuses on the Middle East and North Africa.

"In the developing world, there's been a tipping point where you realized you could make more as a shareholder than by stealing from a firm," Harmon says, dusting the flour off his shoes. "That genie is out of the bottle, and it's never going back in."

In 1980 in Peru, a guerilla movement called the Shining Path launched a national terror campaign marked by executions, kidnappings, and bombings. "We were the Cambodia of Latin America," says Fritz Du Bois Freund, a local newspaper columnist, over breakfast on the waterfront strip of Miraflores. Katiana Guzman MacNabb, Harmon's Peruvian-born senior portfolio manager, recalls a childhood of armed guerillas stopping the buses she rode with her mother, sometimes roughing up passengers and throwing them into the back seats of their cars within full view of everyone. "It was such a reign of terror," she says. "You just wanted to stay at home."

The army and paramilitaries finally clamped down on the violence in the early 1990s. Now, when the 40-year-old Guzman McNabb is back in Peru, her daily routine consists of visiting new department stores and company CFOs with her laptop and spreadsheets in hand. Apartment buildings are rising from the ground, along with mega shopping malls and new hotels. The economy can't seem to cool off.

Surrounded by the smog and cacophony of Paseo de la República, Lima's main commercial thoroughfare, Harmon and Guzman are berating themselves for not scooping up shares in Graña y Montero, Peru's largest construction and engineering firm. They've just put on steel-tipped boots to tour the company's signature commercial project: the Westin Libertador, a luxury hotel-condominium due to open in Lima's financial district next year. Graña y Montero's stock collapsed when a Peruvian pension fund had to liquidate its long-held position in February 2009, but it has since more than tripled. "I'm not paying this much," says Harmon. "We'll get a good construction stock cheap somewhere else, maybe Egypt."

Harmon grew up in Mamaroneck, N.Y., and studied at Brown University and Wharton business school. Between 1986 and 1996, he was chairman and chief executive of Schroder Wertheim & Co., a boutique investment bank that was later acquired by Citigroup. He and his wife of 53 years, Jane, a Tony-award winning producer, became fixtures on the Broadway theater circuit.

The road to Lima began in Washington in 1997, when President Bill Clinton named Harmon, a longtime Democratic fund-raiser, chairman of the Export-Import Bank, a government agency that finances foreign purchases of U.S. exports. Harmon says he had never heard of Ex-Im. He had also barely traveled abroad.

As it turned out, Asia was in economic turmoil. Russia and Latin America would soon follow. Amid frenzied efforts to help developing economies continue to purchase American goods, Harmon practically lived in hotels and on airplanes. He learned a few things about developing populations in the process: That they resented the "Third World" label and hated it when the IMF swooped in and imposed draconian measures in return for aid. "'They're going to snap back,' I remember thinking to myself," Harmon recalls, referring to Asia. What ensued in most emerging markets was a decade of fiscal restraint, in contrast to the credit binge in the U.S. and Western Europe.

By the time Harmon's tour at the

PREVIOUS SPREAD: LORENZO MOSCIA/REDUX; SCHALK VAN ZUYDAM/AP PHOTO

Dhaka, Bangladesh: The stock market is up 1,105 percent over 10 years



Ex-Im Bank ended in 2001, the vast majority of its loan assistance was going to private companies—a turnabout from the government-run clientele it chiefly dealt with in 1997. Harmon launched Caravel in the autumn of 2004. The fund's client pool consists of wealthy individual investors, families, and institutions.

In an investment universe that can include everything from Zambian beef co-operatives to Vietnamese dairy farms, Harmon quickly learned that local expertise is critical. He and his 12-person team have visited 60 countries in search of investments. The process begins with a list of 6,500 publicly listed securities in both frontier and lower-tier emerging markets. Because frontier equities are often thinly traded and have miniscule market values, an otherwise routine $1 million buy order can take weeks to fill and can send a stock price surging. Accordingly, Caravel whittles its initial list down to 600 to 700 securities that can be bought and sold in big blocks without rocking the market. "We can get out of our entire portfolio in 45 days," Harmon says.

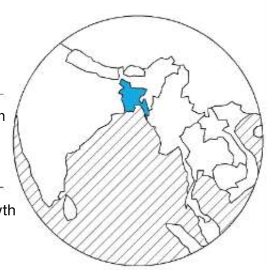
Caravel has more money invested in the Philippines than in any other country.

BANGLADESH

Population
156m

5-Year GDP Growth
27%

YTD Market Growth
64.6%



One of the world's top garment makers, supplying H&M and Zara. Its bank sector is also booming.

In 1998, when Harmon ran the Export-Import Bank, the Philippines was so weakened by the Asian financial crisis that the government was unable to pay its bills. Today, corruption and cronyism still run rampant. An al Qaeda splinter group terrorizes tourists, and the capital, Manila, suffers from a shortage of potable water. Metropolitan Manila, which consists of 16 cities with a total of 20 million people, is the world's densest municipality.

Despite these seemingly intractable challenges, the Philippines boasts high consumer confidence and a well-capitalized banking system. Harmon, on the recommendation of deputy portfolio manager Caglar Somek, invested 7 percent of his fund in the Manila-based casino operator Alliance Global, which caters to the growing class of Filipinos with extra money to blow on gambling. Caravel has another 6 percent of its assets in Bangladesh, and has also been putting money to work in Egypt by investing in Telecom Egypt.

Developing markets have been boosted by the rise of China and its imports of food and raw materials. The Philippines, Bangladesh, and Peru are particularly dependent on China to fuel their rocketing growth, though Mark Mobius, the executive chairman of Templeton Asset Management in Singapore, isn't especially concerned. "Frontier markets," he says, "are in many cases now in their takeoff stage, where self-sustaining development is taking place as a result of high consumer spending in the home markets."

Frontier investing can be rewarding but perilous. Caravel lost half its value in the crash of 2008, when investors around the world were liquidating

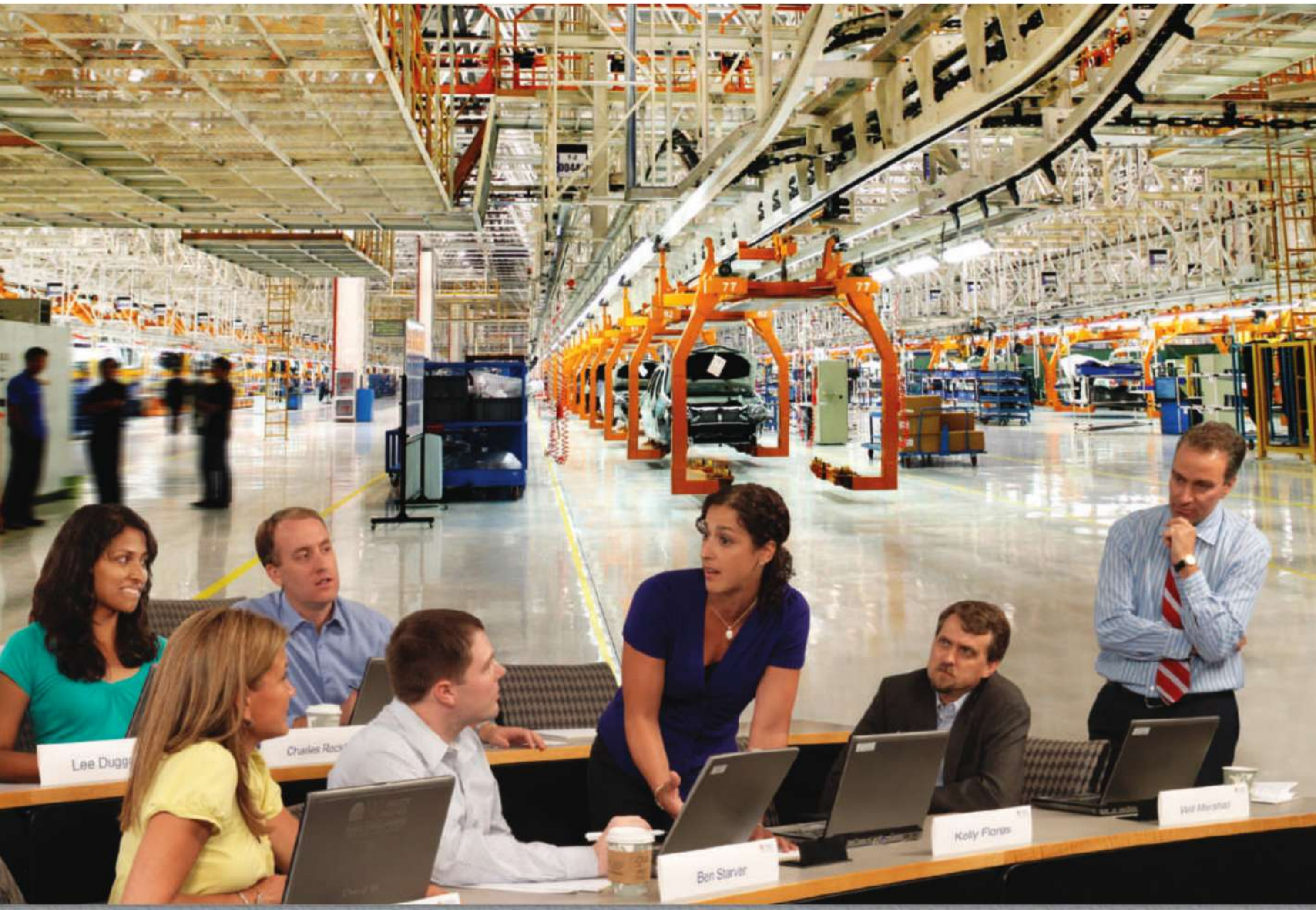
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Manila, Philippines: The country is Caravel's largest weighting

just about anything in their portfolios that they could. Newly developed economies also pose a heightened risk of economic and political relapse. Moreover, economists debate the question of the relative benefits of foreigners buying stocks in poor countries rather than investing in roads and dams. "Ideally, if you're looking to help people in developing economies, you want long-term capital," says Stephany Griffith-Jones, a Columbia University economist who specializes in capital flows to developing markets. Harmon, for his part, says that his investments are not only lasting but that they also bring his voice into local corporate governance. "If companies and governments want my continued investment," he says, "they have to show me they're listening." The upshot, he says, is fulfilling one of his career aspirations: "doing well by doing good."

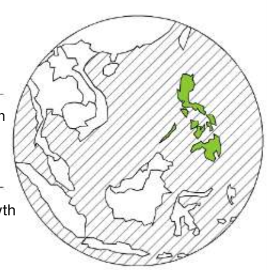
Harmon had an epiphany in 1998, when Hillary Clinton urged him to pay his first visit to Africa. He flew into Ghana, the democratic nation of 23 million people in western Africa. Within days, he found himself buying used refrigerators for a group of women in a fishing village who were losing much of their daily catch to spoilage. "I didn't think much of it," he remembers. "A couple hundred bucks–worst case I was making a donation." Almost immediately, though, the women multiplied their sales, greatly reducing the time they had to spend out at sea. Harmon was repaid in half the time he expected. Within months, Ex-Im Bank was issuing loan guarantees to the Ghanaian fishing village. "I felt better about myself than I ever did on Wall Street," he says. "I was never happier."

PHILIPPINES

Population
98m

5-Year GDP Growth
18%

YTD Market Growth
36.5%



The economy grew by 7.9 percent in the second quarter, and the Philippine Stock Exchange is at a record high.

Fast-forward 12 years. Ghana is one of the world's fastest-growing economies. Brokers there report that they can barely keep up with buy orders for Ghanaian shares (Caravel's included). A half-century ago, Ghana and South Korea were economic equals. The latter is now 25 times the size of its sub-Saharan counterpart, churning out hundreds of billions of dollars worth of Samsung LCDs and Hyundai sedans. South Korea, which is now the world's 15th largest economy, has all but graduated to developed-market status. It's the kind of success story that Harmon and his investors love to regale skeptics with.

Back in Lima, on a wave-battered cliff overlooking a gorgeous stretch of the Pacific, sits a new open-air mall with a Chili's restaurant and a Starbucks. It's midweek, and the venue is crowded with people holding shopping bags and mint lattes. A new luxury Marriott hotel overlooks the plaza. Young couples nibble on roast chicken and sip purple *chicha morada*, the national beverage.

Prosperity suddenly abounds in this once-bombed-out corner of Latin America. Not that Jim Harmon is so eager for you to know that. B

PHILIP LAURELL/GALLERY STOCK; DATA: BLOOMBERG; CIA FACTBOOK; IMF

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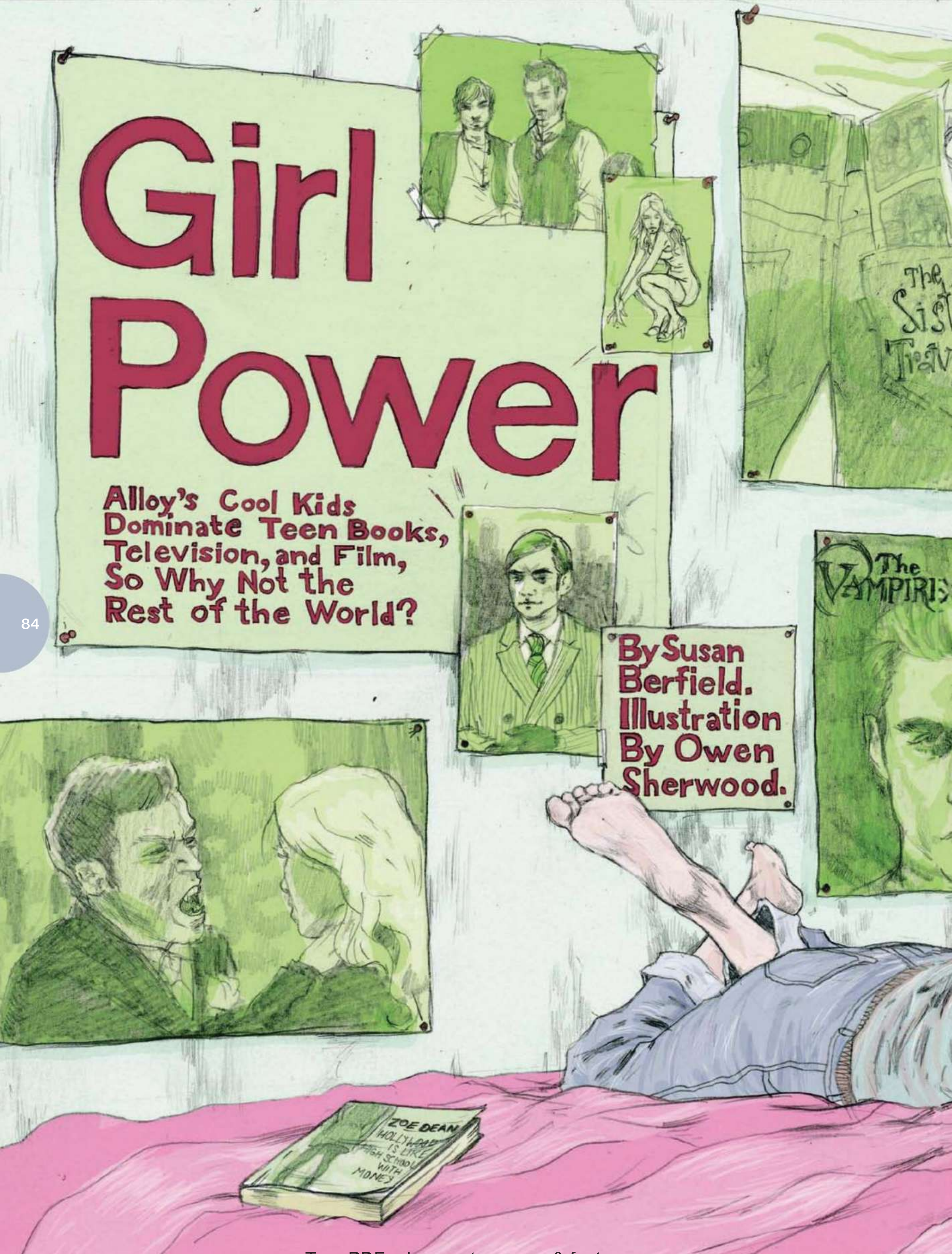
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Josh Bank is a cheerful guy in a red-checked shirt and pressed khakis with millions of young women under his influence.

On this Sunday morning in Los Angeles, several of those women are on the set of his new Web series, *Hollywood is Like High School with Money*. Bank, 42, the president of Alloy Entertainment, is one of the creative forces behind hits like the television show *Gossip Girl* and the novel and movie *The Sisterhood of the Traveling Pants*. Perched in a director's chair, his eyes alert, Bank watches two actresses run through lines he thought up with another set of charges, the mostly young, mostly female editors and writers who churn out stories for him at Alloy.

"I love the idea of a teenager giving an adult rules about how to survive in Hollywood. It still makes me laugh," says Bank about his show, which revolves around Quinn, the high school Queen Bee, who teaches a hapless studio assistant named Taylor how to outmaneuver a ruthless rival. Then he turns serious, describing the icy derision that is the signature mood of Alloy stars, many of whom are studies in the Machiavellian teen. "I insisted when we were writing the script that Quinn be absolutely intolerant of everything Taylor does in that classically teenage girl way," he says. "Quinn doesn't give an inch."

The other millions of young women under Bank's influence? They watch Alloy's *Twilight* knockoff, *The Vampire Diaries,* and *Huge,* the critically acclaimed show about teens at a fat camp. They read Alloy books like the best-selling series *Pretty Little Liars,* which was conceived as *Desperate Housewives* for teens; eight such products have been on *The New York Times* best-seller list this year. Nearly 21 million teens logged on to Alloy's websites in September, according to tracking service comScore, and 6 million see Alloy's ads on its in-school television network, Channel One News. *Private,* Alloy's first Web series, got 14 million hits and convinced Bank and the other executives that their digital future had arrived.

On the Web, Alloy hopes to do what it can't on television or in film: control the content, the distribution, and the advertising sales, and thus the profits, for its shows. If all goes according to plan, Alloy could be a digital studio and broadcaster in one. It could own the teenage girl, and maybe even the holy grail of demographics, prized for its spendthrift, trendsetting ways: the 18- to 34-year-old woman. Maybe Hollywood really is like high school: Rule No. 1, says Quinn, is "Be aggressive."

In June, Strauss Zelnick, head of the private equity firm ZelnickMedia, and other investors paid $126.5 million to acquire Alloy Entertainment and its publicly traded parent company, Alloy Inc., which also includes a youth marketing and research firm. When the deal closes later this year, Alloy will have an ambitious owner in Zelnick, who was once president of 20th Century Fox and is also trying to revive video gamemaker Take-Two Interactive. "I expect them to be nothing less than the most important entertainment company serving the youth market," he says. With Zelnick comes a new chairwoman, Geraldine Laybourne, who pretty much invented the cable channel Nickelodeon and founded another, Oxygen Media, and now wants to influence a new generation. She used to tell Sumner Redstone, her boss at Viacom, that Nickelodeon wasn't just a channel, it was a lifestyle. She has something similarly grand in mind for Alloy. "We can get under the skin of this huge market," she says, noting that teens are at once ubiquitous and elusive.



Alloy stars rehearse their cold stares



The makeup for *Hollywood* is from sponsor L'Oréal

"Are we going to be an important content creator and brand for young adults? Yes. What shape that takes, I don't know. We're creating something new."

In some ways this is Alloy's own coming-of-age tale. The company wants to grow up on its own terms, idiosyncrasies intact. And it's doing so just as those millions of teen girls are getting hold of the mobile technology that could let Alloy's stories beguile them almost anywhere. There may or may not be a TV in the 21st century teenager's bedroom, but there will quite likely be a laptop or tablet. "I'm excited about what the iPad means for this generation," says Laybourne. "Once tablets are in their hands, Alloy is perfectly positioned to create new content."

Online video is already huge. Eighty-four percent of the 213 million Internet users in the U.S. now watch an average of 14 hours of video a month, according to comScore. And in September, ads accounted for more than 12 percent of all videos viewed online.

Other companies, of course, share Alloy's ambitions. Over on Sony's well-funded crackle.com, the most popular series, *The Bannen Way* (about a con man doing one last job), drew 13 million views in its first two months. Results like that are bringing the traditional television players into webcasting—again. They tried it a few years ago, and when those attempts failed they scaled back their plans. Now the networks and big studios are aiming higher with original Web series. NBC is airing a comedy, *FCU: Fact Checkers Unit*, about magazine assistants trying to confirm celebrity gossip. Lionsgate recently announced it will produce its first Web show, a 24-episode animated series called *Trailer Trash*.

The real experiments, weird and funny, are (no surprise) occurring outside Hollywood. CollegeHumor, which is owned by Barry Diller's IAC, has 15 million monthly users who watch shows like *Hardly Working*, the absurdist sketches that star CollegeHumor's staff and are filmed in its offices. At My Damn Channel, the independent Web studio, the most popular original series so far is *You Suck at Photoshop*, a combination tutorial and comedy routine that's been seen more than 24 million times.

Seen by whom? Quite likely young men. If there is a market in which teen girls are underserved, digital entertainment may be it. Vuguru, the studio founded by Walt Disney's former chief executive

PHOTOGRAPHS BY LAUREN GREENFIELD FOR BLOOMBERG BUSINESSWEEK

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officer, Michael Eisner, offers a few such shows, including *Prom Queen*, a series of 90-second episodes that has attracted 11.1 million views. And the new MTV Scratch is going after millennials from all angles. But so far no one can really match Alloy's near-obsession with the fantasies and anxieties of young women. "They want to be the place for everything that teenage girls want," says Reed Phillips III, co-founder of media investment bank DeSilva+Phillips. "Their chance of success is pretty high."

For its first online shows, Alloy adopted a conventional Internet model, where the advertiser pays for the series. *Hollywood is Like High School* is a 10-episode, seven-figure Web production, with all seven figures coming from L'Oréal. Even with advertisers bankrolling the programs, however, Alloy doesn't quite break even. For now that's close enough for Matt Diamond, CEO of Alloy. He thinks economies of scale will eventually work in Alloy's favor, particularly if it can turn some of the series into feature films, as it's doing with *Private*, now in development, or into television shows.

Inside the Alloy empire, there are few worries about protecting creative work from the influences of advertisers, unlike in many more traditional media organizations. This may be due in part to the backgrounds of Diamond and Leslie Morgenstein, the CEO of Alloy Entertainment. Diamond, 41, worked at General Electric and got his MBA from Harvard before he and a friend started Alloy in 1996 as a youth marketing company. Four years later, he bought Morgenstein's book-packaging business, 17th Street Productions; Morgenstein, now 43 and with an MBA of his own, brought in Bank, a college friend from Sarah Lawrence College who was working at an advertising firm. All three are understated, unthreatening, apparently uncomplicated. Their hair is short, their shirts are tucked in. They're married and have kids. They run and play golf. The widget they sell just happens to be the attention span of teenage girls.

"The goal is to make advertisers super happy and make us super happy," Morgenstein says. "They don't want to write the script," adds Diamond. "But they won't put money into something that won't ultimately be a good ad campaign."

Two months after L'Oréal signed on to *Hollywood*, executives from the company were reading over the script. "They were very helpful in saying where they'd like to see their product," says Bank. The second episode's script reflects this cooperation: "Stage Note: Quinn applies Telescopic Explosion Mascara and primps in front of the mirror. In her bathroom we see 360° Go Clean, L'Oréal Hairspray, Infallible Lip Gloss, True Match Roller, True Match Blush, eyeliners and lipliners."

On the set, advertisers were just as helpful. "If the sponsor sees something they don't like, they'll speak up and we'll change it," says Tripp Reed, an independent filmmaker who joined Alloy to produce its digital programs. L'Oréal executives declined to comment.

In September, Alloy also introduced a series called *First Day*, created expressly for Kmart. It's a comedy about a girl who relives her first day at a new high school, in different Kmart clothes each time, until she gets it right. Kmart executives had one concern: no mean girls. That might sound crippling—like having a superhero without a villain—but Alloy complied. "We really just tweaked some of the dialogue," says Andrew Stein, the vice-president of marketing and planning. "It wasn't that difficult." When the shows air, viewers can click on certain outfits and be taken straight to Kmart's website to buy them.

Does this relentless focus on product make the stories suffer? Bank and Morgenstein say it doesn't. "There's never been a case where we felt we sacrificed quality," says Diamond. But working so closely with companies is likely more challenging than they let on. Laybourne, who brought advertising to Nickelodeon, concedes that in general, "The sales process in branded entertainment often gets in the way of figuring out the best creative solution." So even as it starts work on a third series, *Talent* (backed by Procter & Gamble), Alloy is looking to reestablish some boundaries. It will continue to produce as many as eight branded shows a year, but it also wants to finance its own programs. Advertisers, Morgenstein says, will have nothing to do with the content. They'll buy airtime and maybe some product placement. "We still want advertisers to play with us, but we want to fence them off a little bit," he says. "We'll walk right up to the edge. It will be more like what we've done on TV."

Zelnick already seems to be enjoying the possibilities at Alloy. "Do we get engaged in reality shows?" he asks. "What use do we make of the enormous reach of our digital network?" Diamond, who helped take Alloy private and will stay on as CEO, offers his own riff on Alloy's future. "We're at an inflection point," he says. "Gerry got what others don't: This is a system that can feed a much bigger media engine. We want to be a more important media company to youth. We want them to know us."

Alloy has never really promoted itself. Now, though, "It's necessary for them to become a brand, particularly if they are trying to be the MTV for teenage girls," says Phillips. "It's necessary if they want to build value with an eye to selling the company in three to five years."

Back on set, Bank is saying, "Someone get her a lobster bib!" Taylor is eating cheese-drenched nachos, and he doesn't want to see a costume ruined. Between takes, he tells the actress playing Iris, the studio boss, to put her hand up to end a conversation. "Iris doesn't pause," he notes. Then he leans back in his chair to muse on what all this means for Alloy. "The computer and TV will become one," he says. "I don't know when, but they will." And that's how millions of young women—who are way ahead of him here—have Bank under their influence. B

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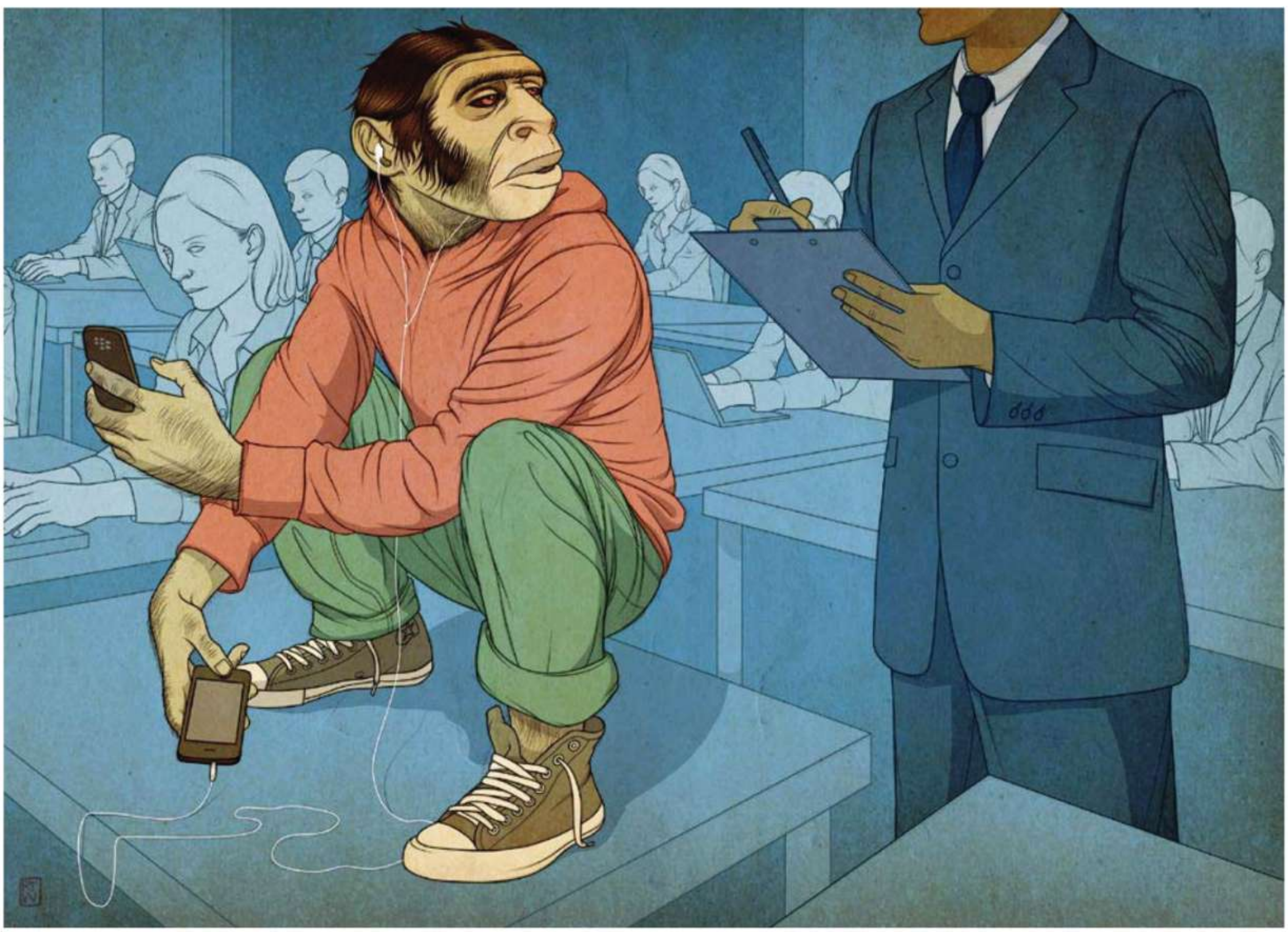
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Etiquette School for Dummies

Amid the recession, white-collar charm classes thrive—and uncover sad truths about today's young professionals. *By Teddy Wayne*

Illustration by Richard Wilkinson

TOP: KEVIN MAZUR/WIREIMAGE

Etc. Etiquette School

A few summers ago, Google intern Gregory Duncan was receiving instruction at his workstation in the company's New York office when a visitor swung by for a chat. Duncan remembers that his engineer-supervisor wasn't very gracious about the social call. "Just a minute," he hissed at the visitor, holding up an index finger in the universal signal for 'I have way more important things to deal with.' The visitor? Sergey Brin.

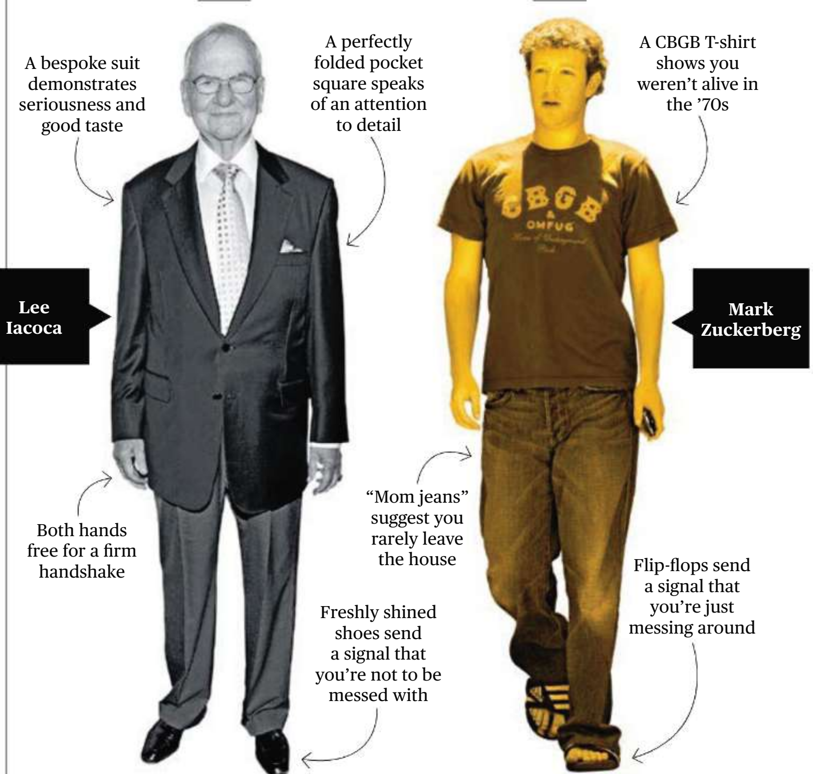
Civility in the workplace has been on the decline since Emily Post published her primer on the topic, *Etiquette in Society, in Business, in Politics and at Home*, in 1922. Even books about etiquette—like the current best-seller *The No Asshole Rule*—lack a certain polish. Yet as hoodie-wearing, emoticon-tweeting millennials graduate college and prepare for the workforce, the low point may just be arriving. In other words, it's a great time to be a professional etiquette coach.

Lyudmila Bloch, a founder of Etiquette Outreach in New York, has seen a significant rise in enrollment at her school—where initial sessions cost $395—since April. Etiquette School of New York founder Patricia Napier-Fitzpatrick has also seen matriculation growth for services that can run up to $300 per hour. "I've been doing this for 14½ years," says Jodi R.R. Smith, president of Marblehead (Mass.)-based etiquette consulting firm Mannersmith, which deals with personal and corporate clients. "Every year has gotten better." Although many of Smith's younger clients vanished during the late '90s and early 2000s, she's now winning back their business. "When we hit the recession, they suddenly they started coming again!" she says. After a 30 percent drop in business from 2008 to 2009, even the Protocol School of Washington—which trains etiquette instructors—has grown in size each month this year. "Ten years ago, it was popular in the over-50 crowd," says Pamela Eyring, the school's president and director. Now, "there's a nice sprinkling of 25- to 30-year-olds." The school currently has a waiting list for protocol officer training.

The surge in enrollment may be the result of job hunters trying to work every angle, but it's also highlighted the professional shortcomings of a generation raised without handwriting classes. While plenty of millennials blame their unemployment on the recession, many aren't exactly helping their cause. "They've grown up with this Web 2.0 mentality that there's complete equality in the world," says Patricia L. Bower, clinical associate professor of management communication at New York University's Stern School of Business. "They think, 'If everyone has access to the same information, then we're all equal, so I know as much as you do even though I'm 20 and you're 55.'" Some lack basic office skills—like experience with a landline. "A lot of kids just text or talk online now. They're not actually

Fig.1
BUSINESS MAGNATE OF YESTERYEAR

Fig.2
BUSINESS MAGNATE OF TODAY



"Ten years ago, etiquette classes were popular in the over-50 crowd," says an instructor. Now college grads are signing up

talking to people," says Napier-Fitzpatrick, who coaches clients on how to modulate their tone in the office. Not surprisingly, many students are clueless about their cell-phone privileges. "A young man came to me and said everyone in the office keeps their phones on in meetings, especially the head of the company," she says. That's when Napier-Fitzpatrick reminded the pupil, "He's the CEO, and you just started!"

Juanita Ecker, whose Professional Image Management etiquette service has offices in Troy, N.Y., and Lexington, S.C., points out a generational rift in the notion of building business relationships. "Boomers want young people to establish relationships the way they do it," she says. "And that's not going to happen. They haven't been coached on how to send an e-mail with complete sentences that's not filled with acronyms."

Another potentially menacing complication is Facebook—and the need to teach young professionals how to avoid getting fired for oversharing. (The phenomenon has become so common that there's even a Facebook group, Fired Because of Facebook, devoted to it.) Ecker cautions her students about the crafty surveillance methods employed by some companies. "Don't assume just because your boss isn't one of your friends that he or she won't eventually see a message you post," she tells them. "Employers sometimes hire college-age people to befriend potential hires so they can check them out. They take it into account when

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they see pictures of drunken parties–and nudity."

Such nuggets of common sense do not dissuade many young workers from the view that etiquette training, or any form of behavior modification, is uncool. William Gruger, a 22-year-old graduate of the University of Colorado Leeds School of Business, says: "There are people who actually delete themselves from Facebook altogether during their job application process. Personally, I think that's crap. If I didn't get a job because of what somebody sees on Facebook, then I don't think I would have been very happy working there in the first place."

Still, Gruger acknowledges that as he and his friends segue into employment, their Facebook walls display fewer salacious photos. "Most people are at that point where they've realized that having pictures of themselves with illegal drugs is somewhat incriminating," he says. "Holding a beer vs. holding a bong is a censorship line people tend to follow." Still, even those who do self-censor remain at the mercy of their friends. "Someone wrote on a friend's Facebook wall, 'I just bought NyQuil for the first time–thinking of you,' " says Robyn Bohn, a 24-year-old corporate trainee at the Sussex (Wis.)-based Quad/Graphics printing company. "It's a long story," Bohn says–one that forced her friend to explain to her colleagues that she's not a cough syrup addict.

Offline, poor wardrobe choices are the most common millennial trouble spot. "The biggest complaint I've heard is that young women are dressed like they're going to a club," says Ecker. Even companies with casual dress standards can have clothing confrontations. When Gregory Duncan attended an intern open house at Google, the receptionist asked him to wear a "Google Open-House Intern" T-shirt. Duncan asked if she was joking. She wasn't. "She said that she was on to me," he recalls, "and that I was disrespectful. I e-mailed her to apologize and said I'd be happy to have a meeting and take her thoughts about that into consideration." She didn't write back.

The receptionist may have been overly attuned to a prevailing sentiment that today's kids aren't all right. Though, when it comes to finger pointing, an old rule applies: Blame the parents. "Helicopter parents' upbringing of this generation, where everything they said from day one was praiseworthy and encouraged, has produced students who are still calling their parents every day and continually receiving positive reinforcement," says NYU's Bower. "I don't think prior generations entered the workforce with this entitlement." That's more good news for the etiquette business. "Parents are taking the initiative to send their kids here," says Bloch. "Some will give it as a gift to a young adult." Such was the case with 20-year-old Elaine Hedaya, whose mother enrolled her in Bloch's Etiquette Outreach. Though its impact on her future employment currently remains unclear, "Now I know how to cut a tomato so it doesn't squirt," says Hedaya. "It's the small things." Ⓑ

Dinner for Schmucks

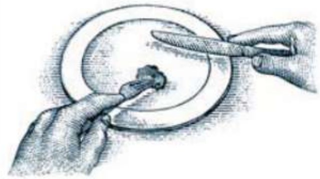
Take heed, young ruffians. Etiquette coach Patricia Napier-Fitzpatrick offers rules and tips for business dining–at a restaurant that doesn't offer value meals.

DRINKING
Booze patrol



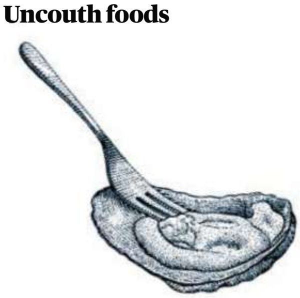
▶Never exceed two glasses of alcohol or the host's own consumption. When drinking wine, hold the glass by the bowl, not the stem, to reduce the possibility of spillage. And don't clink glasses during a toast–it's unnecessarily loud and "just not the thing to do," says Napier-Fitzpatrick. More important, don't ever lift your glass if you're being toasted until after others do. "It's like nominees clapping for themselves at the Academy Awards," she says.

SLICING
Cutting it up



▶The globally friendly Continental style of eating asks diners to keep both fork and knife in hand and to eat off the back of the fork. The less refined American style–switching the fork from the left to right hand after cutting–will do fine, but place the fork at 4 o'clock on the plate and the knife at the top, blade facing you, while idle. To indicate you're finished, place the fork and knife together across the center of the plate at either 3:15 o'clock or 10:20 o'clock.

CHEWING
Uncouth foods



▶In general, Napier-Fitzpatrick suggests, avoid foods such as roast chicken on the bone that are hard to eat gracefully. If you must, however, there are ways to tackle complicated dishes with élan. For oysters, always use a fork–"No slurping! Never," she says. Hamburgers should be cut into quarters. Lobster should simply never be ordered: The bib will make you look like a buffoon. Afterward, if necessary, repair to the restroom for intensive oral spelunking.

PAYING
Other people's money



▶The host should pay for everything, says Napier-Fitzpatrick, including the coat check and valet. Take cues from the host as to whether to order an appetizer, dessert, or drink. If you're the host and are not eating much, make it clear to your guest that he or she can order whatever they like. If you want to tip the maître d', pass him a $10 or $20 bill folded in quarters after the meal (lest you look like you're bribing him). And never, ever take home leftovers.

OPPOSITE PAGE, IACOCCA: MICHAEL TULLBERG/GETTY IMAGES; ZUCKERBERG: CPB/CNB/FINALPIXX/NEWSCOM; THIS PAGE, ILLUSTRATIONS BY STEVEN NOBLE

Etc. Travel

Boutique Hotel Bracketology

An NCAA-style battle for a lifestyle lodging national champion

When New York's Morgans Hotel opened in 1984, its lobby was meant for lounging, the restaurant was intended for more than dinner with grandma, and halls were filled with Robert Mapplethorpe photographs. Widely considered the world's first boutique hotel, it has given rise to today's boutique mania. Now hospitality giants such as Hyatt, InterContinental, and Marriott–which hired Morgans' co-founder Ian Schrager to consult on its new Edition brand –are getting in the game.

According to Portsmouth (N.H.)-based market research firm Lodging Econometrics, there were 410 "branded lifestyle hotels" in the U.S. in the second quarter of 2010, with 62 more set to open through 2011. With all of that growth, it's becoming increasingly unclear what actually constitutes a boutique hotel. " 'Boutique' has no real definition, so technically no one's right or wrong," says Robert Mandelbaum, director of research at Altanta-based Colliers PKF Hospitality Research group. "It stands for outside-of-the-box." That means that hotels with amenities ranging from $8,000 Swedish mattresses and 500-thread-count sheets to, more recently, bathrobes for pets and "spiritual menus" offering sacred texts fit the bill.

The only way to accurately judge a boutique hotel is by evaluating, for lack of a better word, its boutiquey-ness. Herewith, the nation's top newcomers from all regions compete for boutique supremacy. Only one can be crowned champion. Ⓑ

—*Kurt Soller and Geraldine Campbell*



'50s-style cabanas at the Avalon

CONTESTANTS



A Nicoletti Italia "Celebrity Bed" at the Ames

EAST

Ames
Boston
Opened in 2009; 114 rooms; from $195/night

The Surrey
New York
Renovated in 2009; 190 rooms; from $449/night

The Jefferson
Washington
Renovated in 2009; 99 rooms; from $300/night

Hotel Monaco
Baltimore
Opened in 2009; 202 rooms; from $189/night

SOUTH

The Betsy
Miami
Renovated in 2009; 63 rooms; from $249/night

21C Museum Hotel
Louisville
Opened in 2006; 91 rooms; from $199/night

Hotel Saint Cecilia
Austin, Tex.
Opened in 2008; 14 rooms; from $295/night

Postcard Inn
St. Petersburg, Fla.
Opened in 2009; 196 rooms; from $119/night

MIDWEST

Viceroy Snowmass
Snowmass, Colo.
Opened in 2009; 173 rooms; from $225/night

Amangiri
Canyon Point, Utah
Opened in 2009; 34 rooms; from $850/night

The Wit
Chicago
Opened in 2009; 298 rooms; from $109/night

Le Méridien Chambers
Minneapolis
Opened in 2006; 60 rooms; from $249/night

WEST

Hotel deLuxe
Portland, Ore.
Opened in 2006; 130 rooms; from $129/night

Ace Hotel and Swim Club
Palm Springs, Calif.
Opened in 2009; 180 rooms; from $119/night

Edition
Waikiki
Opened in 2010; 353 rooms; from $375/night

Avalon Beverly Hills
Los Angeles
Renovated in 2009; 84 rooms; from $270/night



The Surrey
The Ames' apartment suite has Korres products for bathroom pampering. But the Surrey stocks Italian cotton Pratesi bathrobes–for pets.

The Jefferson
The Jefferson lends belts, dress shoes, collar stays, and cufflinks–which is more sophisticated than the goldfish Hotel Monaco lets guests put in their rooms.



21C
The Betsy has orchids on display in the guest rooms. The 21C is situated in a 24-hour art museum with rotating displays.



Hotel Saint Cecilia
The Postcard Inn hosts touring rock bands, but the Saint Cecilia lets you be the D.J. by borrowing vintage vinyl from the library to play on in-room turntables.

Amangiri
Would you rather recharge your electric car at the Viceroy or your soul at Amangiri's secluded 25,000-square-foot spa in the middle of the desert?



Le Méridien Chambers
The Wit provides Rubik's cubes at turndown, but the Chambers offers a better way to stretch your mind: the hotel's 200-odd piece collection of modern art.



Hotel deLuxe
Diner food at the Ace's King's Highway restaurant, the site of a former Denny's, is nothing compared to the religious texts on deLuxe's spiritual menu.

Edition
Star interior decorator Kelly Wearstler gave the Avalon its updated look. However, guests can watch movies under the stars at the Edition's outdoor theater.



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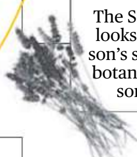
The Saint Cecilia stocks caviar in the minibar



The Edition offers guests poolside iPads



The Jefferson's restaurant offers 1,200 wines



The Jefferson
The Surrey's roof garden overlooks Central Park. The Jefferson's spa offers treatments with botanicals from Thomas Jefferson's Monticello garden.



21C
The Saint Cecilia's minibar offers duck rillettes, but the 21C features the crowning sign of boutique kitsch: taxidermy.



21C
The Jefferson's lobby display of the founding father's documents is interesting—but not as cool as the Chuck Close and David Hockney pieces at the 21C.



Amangiri
Amangari sets up local treks, canyoneering, and archaeological tours. The Chambers only provides free admission to Walker Art Center.

Edition
The Amangiri's courtyard pool is situated around a rock escarpment. The Edition's private lagoon has sand imported from other Hawaiian islands.

21C
The height of boutiqueyness is exemplified in the 21C's waterfall urinal that doubles as a one-way mirror into the lobby. And its 42 four-foot-tall recycled-plastic penguins, which were shown at the 2005 Venice Biennale. Their current purpose remains unclear.

Edition
The deLuxe supplies guests with Twister, which doesn't work waistlines like the Edition's in-house bikini boot camp.



Exhibitions rotate every six months at the 21C

Amangiri sits on 600 acres



BLACK AND WHITE PHOTOS: GETTY IMAGES (9)

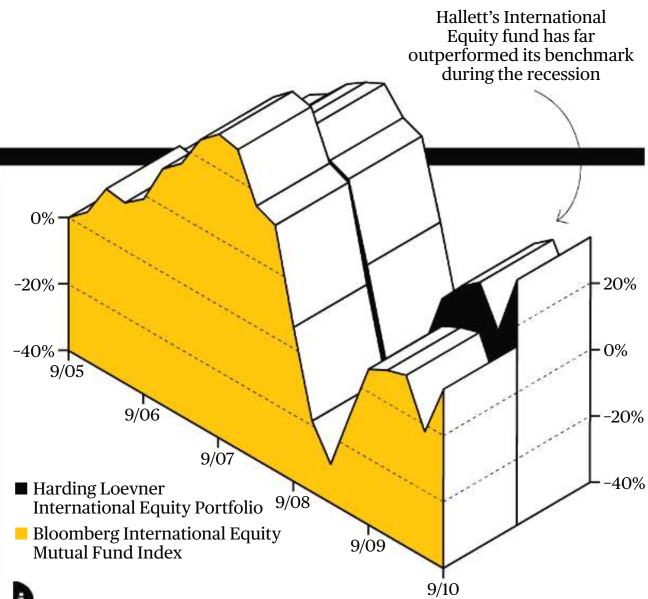


Following Buffett for Idiot-Proof Growth

In the Harding Loevner International Equity Portfolio, Simon Hallett focuses on (really) long-term growth strategies

I take Warren Buffett's view that companies will always make errors. It comes from his line about how you want to be invested in businesses that can be run by idiots because one day they will be. We focus on high-quality stocks with proven long-term growth strategies. You can't have any insights into short-term performance. You can only really generate insight that captures excess returns by doing the research and finding the advantages a company has that will pay out over many years or even decades. Our worldview is that it'll be a tough slog. In the developed world, we've barely begun de-leveraging. Companies are relatively well positioned if they have strong balance sheets and good emerging-markets exposure, which will be a big part of top-line growth. Ⓑ

—As told to Suzanne Woolley



THE STATS DATA: BLOOMBERG

Staying largely out of bank stocks hurt Hallett in the mid- to late '00s, but over the past five years his $554 million fund has returned an annualized 6 percent, vs. 2.7 percent for its benchmark index.

Hallett on his plays



1. Nestlé

Nestlé is never a short-term star in the markets, but over 20 years the stock has returned an annualized 14.7 percent in U.S. dollars, including reinvesting of dividends. It has a long history of spending a lot on research and development, and can be quite inventive. And it has a history of extending brands in ways that please customers. Nestlé surfed the coffee wave by developing packaging systems like Nespresso. At 54, it's about 30 percent below our fair value estimate.



2. LVMH

Any large global consumer company will be looking to emerging markets for growth. LVMH has a very high share of luxury goods in markets like China, where sales of high-priced brands have been growing very rapidly. It's also very big in Japan, and in India it has grown its watch and jewelry segment to 10 to 12 percent of market share. Watches are its most recent new category, and its most recent new market is Brazil, where it purchased an online fragrance retailer.



3. Air Liquide

I believe in the vibrancy of capitalism, where high returns tend to get competed away. It's a company's competitive structure that protects high margins against competition. The industrial gas industry is thoroughly dominated by four companies, including France's Air Liquide. So you have bargaining power over suppliers and can raise prices if your costs rise. The business tends to grow at 1.5 times gross domestic product. Air Liquide has had remarkably steady growth.



4. Unicharm

We're investing in companies that will benefit from aging populations. We own Unicharm, a Japanese company that makes products like adult and infant diapers. Adult diapers have high margins and sales have grown in Japan as well as in other developed countries, where the potential is large. Unicharm is also heavily exposed to China. The company has not only survived the deflationary market in Japan—where the price of a diaper is as low as it is in China—but also managed to sustain high margins.

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Clawing to the Top of the Pack

Since Holden launched his first lobster shack in April 2009, the staff has grown from 11 to 40

After years of mergers and acquisitions, Luke Holden left for a life of lobster. *By Alexandra Wolfe*

Growing up in Cape Elizabeth, Me., Luke Holden worked at his father's seafood processing company, which supplied Whole Foods and the U.S. government. After he enrolled at Georgetown University, his parents instructed him "to stop lobstering and find other internships," Holden says. He accepted one at Swiss bank UBS that led to a job at the New York-based boutique investment firm Cohen & Steers Capital Advisors in July 2007.

During his two and a half years there, Holden, 26, worked from 9:30 a.m. to 1 a.m. on Excel models for the mergers and acquisitions department and other groups. When the recession hit at the end of 2008, the pace slowed at work–and at his father's business, too. Around this time, Holden was growing disillusioned with the paltry state of the lobster roll in New York. "They were all selling for $24, but you got only a little lobster, a lot of mayo, and more filler," he says. He saw an opportunity, and he knew where to find a good distributor.

Holden and his father split the $75,000 startup costs as the young analyst looked for a restaurant location. He ordered equipment during his lunch breaks, and in September 2009 signed a lease on a 300-square-foot storefront in New York's East Village. Holden subsequently hired a partner and pulled in friends to decorate the space with vintage buoys and lobster traps. In October 2009, Luke's Lobster opened with 11 employees–including Holden, who worked nights and weekends while maintaining his day job. When the store began selling 300 sandwiches per day, Holden looked for a second location on the Upper East Side. He gave notice at his firm the day he signed the new lease this April.

Both stores have turned a profit, Holden says, owing in part to money saved from his distribution deal. And, perhaps, because customers appreciate his prices: A lobster roll, chips, and a soda will set you back $16. His banker hours now seem like a cake walk. Holden often starts work at 7:30 a.m. and closes shop at 2 a.m. At least his old bosses are now his clients. "Tomorrow," he says, "I think I'll bring them some lunch." Ⓑ



A PINCER ON PROFITS

500 Average number of customers at the two Luke's restaurants on a Saturday night	**75%** Salary decrease from a career in investment banking to one as a restaurateur
3.2 Number of lobsters (knuckle and claw meat only) used to make one sandwich	**180** Trips made to his father's seafood processing plant in Maine over the last year

DATA: LUKE'S LOBSTER

One lobster roll with soda, chips, and pickle is $16 at Luke's Lobster



PHOTOGRAPHS BY MARTHA CAMARILLO FOR BLOOMBERG BUSINESSWEEK

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The state's marketing force: Tony, The Situation, and really big hair

Spreading the Jersey State of Mind

The state's worst stereotypes have created a marketing boon—and others are noticing. *By Joel Stein*

New Jersey doesn't do shame. When 49 states make fun of your smell, your mafia connections, your accent, your big hair, and what exit you're from (don't other states have highways?), offense becomes your best defense. Especially when you're naturally predisposed to offend.

Owing to shows such as *The Sopranos* and, more recently, *The Real Housewives of New Jersey*, *Jersey Shore*, *Jerseylicious*, *Jersey Couture*, and *Boardwalk Empire*, no other state has been branded so vulgarly—and brilliantly. The Seaside Heights Business Improvement District claims *Jersey Shore* directly increased 2010 daily beach revenue by 38 percent from an already record-breaking 2009. People can get sand anywhere. They'll travel to see a guy punch Snooki in the face.

"When the economy hit rock bottom, people thought of us!" says a North Dakota booster

The only place to have intentionally pulled a Jersey with their government-paid tourism campaign is Las Vegas. The city switched from a decade of marketing itself as a wholesome family vacation destination to acknowledging that people go there to gamble recklessly and share hotel rooms with complete strangers in its hugely successful "What happens in Vegas, stays in Vegas" campaign. Yet with so much reality TV being made, producers are actively seeking other locales willing to put their worst foot forward in exchange for some exposure.

Rebecca Toth Diefenbach, a partner at Sirens Media and the executive producer of Bravo's *The Real Housewives of New Jersey,* is on the hunt for the next "It" state. "There are a lot of states—West Virginia, Louisiana, Mississippi, Alabama—that are

ILLUSTRATIONS BY JIRO BEVIS

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fully developed cultures people don't know about and haven't experienced," she says. Alex Duda, the executive producer of the Style Network's *Jerseylicious*, also thinks the next hot state is hiding in the South. "It's sleepy, but there are secrets there," she says.

The search goes on at a time when many states are already trying to tap their own inner Jersey—whatever that may be—with mixed success. Alabama's current campaign, "The Year of Alabama Small Towns and Downtowns," and forthcoming one, "The Year of Alabama Music," both capitalize on one of the state's better known trademarks—hick culture. Perhaps because of this, not everyone is sure that Alabama's ready for its close-up. "I think it's a double-edged sword if a state turns control of its image over to unstructured situations," says Lee Sentell, director of the Alabama tourism department. "I've read there are six shows with New Jersey connections these days. I'm not sure what the goal is. I don't keep up with the Kardashios." After learning that the "Kardashios" are actually the "Kardashians," and that none of them have anything to do with New Jersey, Sentell was reminded of the power of the state brand: Anyone wearing that much makeup is presumed to live there.

Arkansas also has stereotype issues. "A lot of people still think that we're backwoods, and we're not," says Dena Woerner, communications director for the state's department of parks and tourism. However, its slogan, "The Natural State," makes it a common Google search for many reality TV watchers. "It causes us some trouble on search engine optimization," admits Woerner.

Other states wish they had stereotypes—or anything at all—to exploit. "When people think of New Jersey, it's going to be the shore; South Dakota, it's going to be Mount Rushmore," says Sara Otte Coleman, the director of North Dakota's tourism division. "We don't have that one thing." As a result, North Dakota is pushing other benefits—for example, it's really cheap to hang out there. "We market that," says Coleman. "When the economy hit rock bottom, people thought of us!" Though it has courted reality TV shows, North Dakota has not yet had any luck. "Last November was the 75th anniversary of the state capital. We approached *Ace of Cakes* and *Cake Boss* and tried to get them to come out and make a big huge cake. I think we would have gotten a little more traction with the pitch, but we got a late start," Coleman says. Wyoming has experienced a similar media blackout. "We proactively work to engage film and television," says Diane Shober, the director of Wyoming Travel & Tourism. "Though the need for cell service makes things a little more challenging."

Nebraska, which is kind of in the middle northern or maybe slightly western part of the country, has trouble getting people to pull over. "We hear a lot that we're a flyover state or a state people drive through," says Shannon Peterson, the media and

"The need for cell service makes things a little more challenging," in Wyoming

public relations coordinator for Nebraska's division of travel and tourism. Capitalizing on the reputation of being a place people don't fly to, and having an inordinate number of straight roads, the state's slogan is "Rediscover the Road Trip." "We don't come out and say 'Come here and be bored,'" says Peterson. Well, not until now. "We do talk about how it's peaceful here. We have open prairies. It's a place where you can go reflect. We have a lot of bird watching." Nebraska might be the first state suggesting that people come and stay in their hotel rooms.

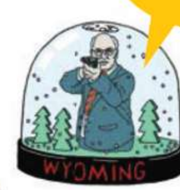
Ohio is trying to present itself as a model of work-life balance with it's New Age slogan, "The State of Perfect Balance." Although if you're LeBron James, it also might sound a bit like a brilliant way of telling people to leave their ambition behind. That's not as bad as Delaware, though. "We'd like to increase our image," says Linda Parkowski, Delaware's director of tourism. She's decided to target sports fans—a brave gambit for a state whose only professional team is a Single-A minor-league baseball club. "We don't need a professional team to create impact," Parkowski insists. "We're talking about youth soccer, anything where the parents travel. Especially girl sports." Delaware would make a nice province in Canada.

While New Jersey has made gaining exposure look easy, even states with undeniable star power are struggling. Despite allowing Sarah Palin to stump for Alaska as a moose-hunting, snowmobile-riding, teenage-pregnancy capital, the state's visitor traffic declined by more than 7 percent from summer 2008 to summer 2009, according to market research firm the McDowell Group. Maybe the TLC network's *Sarah Palin's Alaska* needs to cast the guy who punched Snooki to hang with her for an episode. Ⓑ



"We don't come out and say, 'Come here and get bored,'" says a Nebraska official

Some states have reputations that can be used to build marketing appeal



Is the state encouraging people to ditch their ambition?



How did the mogul build his empire? The authors provide a deal-by-deal (by deal) account



A Billionaire's New Best Friends

A biography of Blackstone's Steve Schwarzman that's long on deals, short on personality. *By Bess Levin*

Steve Schwarzman "was also something of a ladies' man," write David Carey and John E. Morris. Here it comes, the reader thinks, 84 pages into their exhaustively detailed biography: Tawdry stories from Yale classmates about the young man who would be *King of Capital* and eventually build the $14.5 billion private equity empire known as Blackstone. "Schwarzman started a club, the Davenport Ballet Society, and arranged for its members to see a dress rehearsal of the Nutcracker Suite at Lincoln Center," they write. "Later that year, Schwarzman staged a dance festival at which students from nearby women's colleges performed. [Friend] Jeffrey Rosen ... suspects Schwarzman started the club primarily as an excuse to meet girls."

This is high-quality dirt by the standards of *King of Capital: The Remarkable Rise, Fall, and Rise Again of Steve Schwarzman and Blackstone*. Unfortunately, it's about as deep into Schwarzman's personal life as the authors are comfortable delving. It's a useful reminder to readers of the mogul cannon: Books for which tycoons grant access are often short on things one might actually want to know about them.

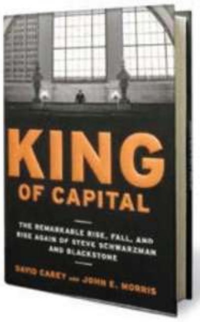
What *King of Capital* does deliver is a diligent–and relentless–focus on the transactions that have shaped Blackstone. Carey and Morris, two veteran private equity reporters, march through virtually every deal the firm has ever worked on, dating to 1985 when co-founders and Lehman veterans Pete Peterson and Schwarzman went door to door raising money. The authors also provide a detailed summary of the deals their competitors worked on, and almost worked on, and paused momentarily to think about working on.

While some dealmaking biographies reflect the singular obsessiveness of their subject's personality, Schwarzman is a more complex character–and that's the problem. Readers looking for insight into the financial guru's personality are greeted with disinterested explanations; even more than loving money, we're told, Schwarzman "hated to lose it." The deepest drilling into Schwarzman's left brain

i

King of Capital: The Remarkable Rise, Fall, and Rise Again of Steve Schwarzman and Blackstone

By David Carey and John E. Morris
CROWN BUSINESS, 400 pp, $27.50



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occurs when the authors describe his falling out with Larry Fink. In 1992, Fink, who then ran BlackStone Financial Management, told Schwarzman he wanted to award shares to new hires—a move that would have lowered Blackstone's stake in the division. Schwarzman rebuffed him in a decision that ultimately led Fink to demand a sale of his unit, which became investment management giant BlackRock. Why did Schwarzman make this costly call? The authors suggest he may have been driven by divorce proceedings with his first wife, Ellen. "When money is as important to you as it is to Steve, and you think you're going to lose 50 percent of your savings," says a former colleague, "you become more difficult." Absent any other examples, readers are left to presume that the breakup with Fink is the singular "fall" of Schwarzman's brilliant career alluded to in the book's subtitle.

A welcome respite from the dealmaking barrage comes in the form of a story told by the head of a rival private equity firm. While walking the beaches of St. Bart's in the '90s, he spotted a massive yacht coming into the harbor. Then, the executive recalls, "two Jet Skis piloted by crew members emerged from the boat and motored in with a cargo of folding tables and chairs, a big umbrella, tableware, a wine bucket, and fancy food. After laying the table, the crew members went back to the yacht to retrieve a tall and striking woman and a shorter man," who—surprise!—turn out to be Mrs. and Mr. Schwarzman on their way to a cozy lunch. "I'm not pleading poverty here," says the executive," but I really did feel like there should be a revolution."

It's an anecdote that acknowledges Schwarzman's love of the luxe life. While his proclivity for $400 crab legs and the $3 million 60th birthday party he threw himself in 2007 are fairly well known, the authors don't drop any hints about whether a more modest 65th birthday is in store. Carey and Morris conclude *King of Capital* with a list of all the investments Blackstone currently holds and a rosy prognosis for its future. The firm came out of the financial crisis "better than many of its competitors," they write (though its stock is down nearly 25 percent over the past year). It has "by far the most diversified mix of business," thanks to Schwarzman's knack for "finding and supplying capital—and for spotting ways to get Blackstone its cut." Steve Schwarzman couldn't have asked for a more respectful book—though he surely warrants a more revealing one. Not to worry: With everything running so smoothly over at Blackstone, Schwarzman should soon be able to carve out time to write his memoir. Perhaps he can answer all the questions *King of Capital* leaves hanging. **B**

Let Them Eat Really Expensive Cake



In 2007, Steve Schwarzman threw himself a $3 million birthday party. The Blackstone co-founder isn't the only mogul to be a guest, and host, of honor. Five other self-thrown affairs to remember. —*Spencer Bailey*

Sir Philip Green
50th birthday, 2002; 55th birthday, 2007
To mark turning 50, the British retailing billionaire flew 200 guests to Cyprus for a three-day, $7.1 million toga party featuring a massive Buddha sculpture and the song stylings of Jennifer Lopez. Five years later, he spent $10 million on a five-day extravaganza in the Maldives.

Oprah Winfrey
50th birthday, 2004
The five-day, $4 million celebration began with a 70-person dinner atop Chicago's then-named Sears Tower before moving west for a luncheon at L.A.'s Hotel Bel-Air. (Maya Angelou wrote a poem for the occasion.) Dinner featured a 23-karat-gold gilded cake.

Simon Cowell
50th birthday, 2009
The *American Idol* judge hired a fleet of limos to drive 400 guests to Wrotham Park, a 250-year-old estate outside London. The $1.5 million party, organized by friend and fellow birthday enthusiast Sir Philip Green, featured pictures of Cowell in the toilet stalls.

David Bonderman
60th birthday, 2002
The TPG Capital co-founder whisked 500 guests to the Hard Rock Hotel and Casino in Las Vegas for private concerts by John Mellencamp and the Rolling Stones. Robin Williams entertained during dinner. The bill: $7 million.

Malcolm Forbes
70th birthday, 1989
The late publishing and real estate magnate spent $2 million to fly nearly 800 guests—Barbara Walters and Henry Kissinger, included—to Tangiers for a three-day blowout hosted by Cleopatra herself, Elizabeth Taylor.



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Etc. Hard Choices

Steven Rattner

"I find it mind-boggling that these companies have come out of bankruptcy yet a plurality of the country still thinks it was a bad idea"

The former auto czar reflects on bailing out Chrysler, firing Rick Wagoner, and the ongoing battle between Washington and Wall Street



The decision whether to save Chrysler: That was a tough call. We had two groups making very articulate, thoughtful arguments. One group of hard-core economists was saying, "Why are we saving Chrysler? It's not a viable company. If we let Chrysler go, it will be a huge value-add for Ford and GM." The people on the other side basically said this was an economy in free fall. On day one, [letting Chrysler fail] would have led to 300,000 jobs gone. It would be a shock the economy couldn't stand.

A dirty little secret is that we weren't going to let GM go out of business. There were some things we couldn't do. If some of the stakeholders hadn't compromised, we could have had a really ugly knock-down fight in the public arena. GM had been planning to fund a lot of their overseas subsidiaries, which would have amounted to sending U.S. taxpayer dollars to all these far-flung places. It might have been a good business decision, but we couldn't do that.

There are a couple of things I regret. I didn't anticipate as well as I should have the degree to which the departure of Rick Wagoner would raise red flags about the role of the government. It might have been better to do that through the board. Also, in his Apr. 30 speech, the President attacked speculators on Wall Street who forced Chrysler into bankruptcy. What I didn't appreciate is how that language would feed into the distrust between Washington and Wall Street. I find it mind-boggling that these companies have come out of bankruptcy yet a plurality of the country still thinks it was a bad idea for the government to get involved. Here was a case in which the private market had failed, the government came in and provided the capital and achieved the most fundamental restructuring of this industry we've ever seen.

One of the things you take away from Washington is that public service today is so thankless, so brutal, so exhausting. Nobody should be surprised that people are turning over. Ⓑ —*As told to Diane Brady*

PHOTOGRAPH BY MIKE MCGREGOR FOR BLOOMBERG BUSINESSWEEK

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